

Vol. VI
TRANSCRIPT OF RECORD

(Pages 2513 to 3040)

Supreme Court of the United States

OCTOBER TERM, 1944

No. 296

PANHANDLE EASTERN PIPE LINE COMPANY,
ILLINOIS NATURAL GAS COMPANY AND MICHIGAN
GAS TRANSMISSION CORPORATION, PETI-
TIONERS,

vs.

FEDERAL POWER COMMISSION, CITY OF DE-
TROIT, COUNTY OF WAYNE, MICHIGAN, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT
OF APPEALS FOR THE EIGHTH CIRCUIT

PETITION FOR CERTIORARI FILED JULY 28, 1944.

VOL. VI.
TRANSCRIPT OF RECORD.

United States Circuit Court of Appeals
EIGHTH CIRCUIT

No. 12,646

PANHANDLE LANTERN FILLING COMPANY, A
CORPORATION, PLAINS, NEBRASKA, PLAINTIFF,
VERSUS A CORPORATION, AND OTHERS,
DEFENDANTS.
AFFIDAVIT OF DEPOSITION.

THAT I, JOHN J. HARRIS, one of the
judges of the said court, do hereby
certify that the foregoing is a true
and correct copy of the deposition
of the said defendant, and that the
same was taken in accordance with
the rules of the said court.

United States Circuit Court of Appeals
EIGHTH CIRCUIT.

No. 12,466

**PANHANDLE EASTERN PIPE LINE COMPANY, A
CORPORATION, ILLINOIS NATURAL GAS
COMPANY, A CORPORATION, AND MICHIGAN
GAS TRANSMISSION CORPORATION, A COR-
PORATION, PETITIONERS,**

vs.

**FEDERAL POWER COMMISSION, CITY OF DETROIT,
MICHIGAN, COUNTY OF WAYNE, MICHIGAN,
MICHIGAN CONSOLIDATED GAS COMPANY,
A CORPORATION, AND MICHIGAN PUBLIC
SERVICE COMMISSION, RESPONDENTS.**

**PETITION TO REVIEW AND SET ASIDE ORDER OF FEDERAL
POWER COMMISSION.**

FILED FEBRUARY 6, 1943.

Index, Volume I.

Original Print

Petition of Panhandle Eastern Pipe Line Company, Illinois Natural Gas Company, and Michigan Gas Transmission cor- poration to review and set aside an order of the Federal Power Commission.....	a	1
Nature of proceedings as to which review is sought.....	b	2
Facts and statute upon which venue is based.....	f	6
Points on which petitioners intend to rely.....	g	6
Exhibit A, Opinion No. 80 of Federal Power Commission.....	q	20

	Original	Print
Order of Federal Power Commission reducing rates, September 23, 1942	rr	38
Exhibit B, Order of Federal Power Commission extending time within which to file new schedules of rates and charges, October 12, 1942	yy	43
Transcript of Testimony before Federal Power Commission	1	45
Testimony	19	46
Manfred K. Toeppen	19	46
C. H. M. Burnham	337	101
Rufus M. Smith	421	136
Glenn G. Bartle	433	137
R. J. Wallace	443	138
Louis Fenn Sperry	452	139
Oscar William Morton	475	151
P. McDonald Biddison	491	159
O. W. Morton, resumed	622	200
C. H. Hinton	653	209
C. H. M. Burnham, resumed	753	238
Leith V. Watkins	854	265
Minutes of meeting of Board of Directors of Panhandle Eastern Pipe Line Company of September 3, 1930	896	285
David Friday	933	303
P. McDonald Biddison, resumed	982	331
Paul Brown Coffman	995	338
P. McDonald Biddison, resumed	1150	430
C. H. Hinton, resumed	1305	487
P. McDonald Biddison, resumed	1408	494
Leith V. Watkins, resumed	1470	509

Index, Volume II.

Louis Fenn Sperry, recalled	1493	521
Ralph E. Davis	1496	522
J. D. Creveling	1588	546
George S. Young	1664	578
Henry C. Leff	1678	584
Howard S. Riddle	1682	587
Francis S. Haberly	1718	601
Fred A. Spitznagle	1871	633
George S. Young, resumed	1890	649
Robert S. Drew	1971	667
Francis S. Haberly, resumed	1983	672
Fred A. Spitznagle, resumed	1952	682
Daniel C. Green	1971	691
Walter C. Beckford	2016	700
P. McDonald Biddison, resumed	2119	712
Excerpt from Exhibit 62	2627	789
O. W. Morton, resumed	2864	892
Letter, O. W. Morton to G. J. Neuner, August 19, 1941	3142	996

Index, Volume III.

P. McDonald Biddison, resumed	3316	1049
Letter, J. D. Creveling to Leon M. Fuquay, July 23, 1941	3643	1053

	Original	Print
Letter, Leon M. Fuquay to J. D. Ceeveling, July 26, 1941	3645	1054
Telegram, Panhandle Eastern Pipe Line Company to Leon M. Fuquay, July 28, 1941	3646	1055
Exhibit 39-A, Statement relating to Reproduction Cost New of Plant, Property and Business of Panhandle Eastern Pipe Line Company, etc.	3785	1075
Rufus M. Smith, resumed	4113	1144
C. H. Hinton, resumed	4165	1174
Rulus M. Smith, resumed	4187	1179
Glenn G. Bartle, resumed	4352	1271
Louis F. Sperry, resumed	4500	1307
C. H. Hinton, resumed	4775	1421

Index, Volume IV.

C. H. M. Burnham, resumed	5939	1929
---------------------------	------	------

Index, Volume V.

Leith V. Watkins, resumed	6163	2037
Paul B. Coffman, resumed	6554	2241

Index, Volume VI.

Leith V. Watkins, resumed	7030	2514
Letter, Ralph M. Shaw to Frank P. Parrish, October 2, 1931	7385	2654
Paul B. Coffman, resumed	7451	2663
George S. Young, resumed	7933	2806
Henry C. Lehn, resumed	8037	2857
F. S. Haberly, resumed	8070	2874
Fred A. Spitznagle, resumed	8172	2921
Limitation Order L-31, "To Curtail Consumption of Natural Gas"	8272	2950
Exhibit A, Areas subject to prohibitions contained in paragraph (c) of Limitation	8280	2956
Robert S. Drew, resumed	8366	2998

Index, Volume VII.

Fred A. Spitznagle, resumed	8461	3050
George S. Young, resumed	8525	3062
Order of Securities and Exchange Commission In the Matter of Columbia Gas & Electric Corporation, et al.	8545	3078
Daniel C. Green, resumed	8558	3080
Robert S. Drew, resumed	8706	3169
Fred A. Spitznagle, resumed	8721	3185
Robert S. Drew, resumed	8741	3188
Leith V. Watkins, resumed	8887	3208
Order of Federal Power Commission denying application for Extension of Time for Compliance with the provisions of Gas Plant Accounts Instruction 2-D of Uniform System of Accounts and Commission's Order No. 73	9020	3235
C. H. Lewis	9023	3236
Leith V. Watkins, resumed	9136	3270

	Original	Print
William G. Maguire	9247	3300
Leith V. Watkins, resumed	9329	3351
David Friday, resumed	9349	3353
O. W. Morton, resumed	9364	3361
Charles W. Smith	9476	3411
Edward L. Dunn	9570	3433
Charles H. Hinton, resumed	9669	3478
C. H. M. Burnham, resumed	9784	3533

Index, Volume VIII.

Leith V. Watkins, resumed	9838	3557
Report, P. McDonald Biddison, Consulting Engineer, to J. D. Creveling, President, Panhandle Eastern Pipe Line Company, November 24, 1941	9890	3588
C. H. M. Burnham, resumed	9898	3592
Leonard Spacek	9928	3608
Letter, P. McDonald Biddison to Panhandle Eastern Pipe Line Company, April 8, 1942	9942	3616
P. McDonald Biddison, resumed	9977	3631
Paul B. Coffman, resumed	10076	3676
P. McDonald Biddison, resumed	10399	3853
Leith V. Watkins, resumed	10452	3882
P. McDonald Biddison, resumed	10534	3919
J. D. Creveling, resumed	10559	3938
Samuel Joseph	10659	3976
Statement relating to Production from Hugoton Field	10679	3987
Letter, O. W. Morton to Federal Power Commission, April 9, 1942	10698	3989
Letter, O. W. Morton to Federal Power Commission, April 11, 1942	10699	3990
J. G. Shattuck	10701	3991
Exhibits:		
1. Statement of operating Results of Panhandle Eastern Pipe Line Company and Michigan Gas Transmission Company, 1938-1940	10775	4012
Operating Results	10775	4012
Cost, and Cost Less Reserves, of Plant and Operating Results as of December 31, 1938	10777	4013
Cost, and Cost Less Reserves, of Plant and Operating Results as of December 31, 1939	10778	4014
Cost, and Cost Less Reserves, of Plant and Operating Results as of December 31, 1940	10779	4015
Working Capital Estimate, December 31, 1938-39-40	10780	4016
Working Capital Estimate Approximate Payroll Basis, December 31, 1940	10782	4017
2. Determination of possible Revenue Reduction of Pan- handle Eastern Pipe Line Company and Michigan Gas Transmission Company	10783	4018
3. Excerpts from Registration Statement of Panhandle Eastern Pipe Line Company filed with the Securities & Exchange Commission, February 12, 1937, with respect to Gas Reserves	10785	4019

4, Excerpt from Registration Statement of Panhandle Eastern Pipe Line Company filed with the Securities & Exchange Commission, November 13, 1940, with respect to Gas Reserves	10786	4021
5, Excerpts from Registration Statement of Panhandle Eastern Pipe Line Company filed with the Securities & Exchange Commission, November 13, 1940, with respect to Design, Construction and Maintenance of Property	10789	4025
6, Statement of Operating Expenses and Taxes at 100% Load Factor Operation	10791	4029
7, Statement as to necessary Price per M. C. F. at 100% Load Factor	10793	4030
8, Statement of estimated Effect of 100% Load Factor on earning Power of System	10795	4030
9, Statement of Factor affecting the Nature and Magnitude of reported Net Incomes	10796	4031
10, Statement showing Effect of Variation in accounting Practices on Reported Incomes of an Enterprise	10799	4034
11, Chart showing Relation of Yield of United States Treasury Bonds and Notes	10800	4035
12, Statement showing United States Treasury Bond Yields	10801	4037
13, Chart showing History of Yield of United States Bonds, 1920-1939	10806	4045
14, Average Yield of United States Treasury Bond	10807	4047
14-A, Securities & Exchange Commission Releases Nos. 2778 and 2834 — Findings and Opinion of the Commission in the Matters of Panhandle Eastern Pipe Line Company, et al.	10808	4047

Index, Volume IX.

Order of Securities & Exchange Commission Denying Applications in Part and granting Applications in Part	10842	4087
Supplemental Order of Securities & Exchange Commission amending Findings and Opinion	10844	4089
17, Miscellaneous Data concerning Property and Operations of Panhandle Eastern Pipe Line Company	10848	4090
Schedule 1, Panhandle Eastern Pipe Line Company System Compressor Stations	10848	4090
Schedule 2, Map of Communities receiving service directly or indirectly from Panhandle Company including Population and Number of Customers as of June 30, 1941	10849	4091
Schedule 3, List of Industrial Customers receiving Service direct from Panhandle Company System, June 30, 1941	10853	4099
Schedule 11, Panhandle Eastern System Summary — Miles of Pipe by Sizes, June 30, 1941	10926	4101
30, Testimony of Rufus M. Smith	10958	4103
Schedule 2, Estimated Original Gas Content in the Texas Panhandle Field under Acreage constituting Reserves of Panhandle Eastern Pipe Line Company as of July 1, 1941	10986	4125

Schedule 3, Estimated Remaining Gas Content in the Texas Panhandle Field under Acreage constituting Reserves of Panhandle Eastern Pipe Line Company as of July 1, 1941.....	10987	4125
Schedule 5, Comparison of Open Flow Potentials in Texas Panhandle Gas Field.....	10990	4129
Schedule 6, Gas Acreage owned and under Gas Purchase Contracts held by Panhandle Eastern Pipe Line Company as of June 30, 1941.....	10991	4131
Schedule 7, Hugoton Production to Argus Natural Gas Company, Inc. by Panhandle Eastern Pipe Line Company, et al.....	10992	4133
Schedule 8, Texas Production to Panhandle Eastern Pipe Line Company.....	10993	4135
Schedule 9, Hugoton Production to Panhandle Eastern Pipe Line Company.....	10997	4143
Schedule 10, Hugoton Production to Panhandle Eastern Pipe Line Company.....	11000	4149
Schedule 11, Analysis of Cumulative Production to Main Line to and including Fiscal Month of June 1941.....	11003	4155
Schedule 12, Comparative Statement of Production and Purchases from each District for the two Years ended June 22, 1940 and June 22, 1941.....	11004	4157
36, Testimony of Glenn G. Bartle.....	11010	4159
Schedule 3, Estimated Original Gas Content in the Hugoton Field, (Kansas, Oklahoma and North Texas Panhandle), under Acreage constituting Reserves of Panhandle Eastern Pipe Line Company as of July 1, 1941.....	11038	4176
Schedule 4, Estimated unmetered Gas from Panhandle Eastern Pipe Line Company Wells in the Hugoton Field Kansas, connected to Argus Natural Gas Company, Inc. as of July 1, 1941.....	11041	4181
37, Testimony and Exhibits, Market Value of Leases of Panhandle Eastern Pipe Line Co.....	11047	4187
R. J. Wallace.....	11047	4187
Summary of Market Value of Leases.....	11064	4199
38, Basic Statistics used in calculating Interest, ad valorem Taxes and operating Expense attributable to unused Capacity.....	12159	4203
39, Reproduction Cost New of Plant, Property and Business of Panhandle Eastern Pipe Line Company and subsidiary Companies as of June 30, 1941.....	12162	4206
Letter P. McDonald Biddison, Consulting Engineer, to Panhandle Eastern Pipe Line Company, August 29, 1941.....	12163	4206
Statement relating to Reproduction Cost—New—June 30, 1941.....	12164	4207
Summary.....	12165	4207
39-A, Reproduction Cost New of Plant, Property and Business of Panhandle Eastern Pipe Line Company and subsidiary Companies as of June 30, 1941.....	13130	4208
Letter P. McDonald Biddison, Consulting Engineer, to Panhandle Eastern Pipe Line Company, August 29, 1941.....	13130	4208

Statement relating to Reproduction Cost New—June 30, 1941	13131	4209
Summary	13133	4209
40, Table showing estimated Main Line Sales, years 1941-1946, inclusive	13149	4211
41, Graph showing Sales and Gas Plant by Years, Panhandle Eastern Pipe Line Company and Subsidiary Companies ..	13150	4213
42, Testimony of C. H. Hinton relating to Future Capital Expenditures and Operating Expenses in Production and Gathering System West and South of Liberal, Kansas ..	13151	4215
43, Schedules presented in connection with the written Testimony of C. H. Hinton	13193	4244
Schedule 1, Additional Capital Expenditures required to produce and gather Basic Load, or Present Requirements	13194	4244
Schedule 2, Additional Capital Expenditures required to produce and gather Anticipated Increased Load	13195	4244
Schedule 3, Estimate of Operation and Maintenance Costs—west of Liberal Panhandle Field — Basic Load	13196	4245
Schedule 4, Estimate of Operation and Maintenance Costs—west of Liberal Panhandle Field — Estimated Future Load	13199	4251
Schedule 5, Probable Production from Panhandle Eastern's own Wells and Wells under Gas Contracts (Panhandle Field) during the Period July 1, 1940 to December 31, 1956	13202	4257
47, Panhandle Eastern Pipe Line Company and Subsidiary Companies, future Capital Requirements, Gas Transmission Facilities, Liberal Station and Eastward	13206	4257
48, Statement showing Balance Sheets per Books Panhandle Eastern Pipe Line Company and Subsidiary Companies, as at each December 31, 1930 through 1940 and as at June 30, 1941	13207	4259
49, Income Statement per Books — Period from April 1, 1932 to December 31, 1941	13210	4265
50, Statement showing Earned Surplus per Books, Period from Commencement of Operations to June 30, 1941	13212	4269
51, Statement showing Capital Surplus per Books, Period from September 1, 1930 to June 30, 1941	13214	4273
52, Statement showing Investment in Gas Plant as at each December 31, 1930 through 1940 and as at June 30, 1941 ..	13215	4275
53, Statement of Dividends paid on Class A and Class B Preferred Stocks from beginning to September 1, 1941 ..	13217	4279
54, Statement of Dividends paid on Common Stock from beginning to September 1, 1941	13219	4280
55, Statement showing Comparison of Sales and Revenue, Principal Industrial Customers, years 1939, 1940 and 1941 ..	13220	4281
55-A, Statement showing Comparison of Sales and Revenue, Principal Industrial Customers, years 1939, 1940, and 1941 ..	13221	4283
56, Statement of Gas Produced, Period from April 1, 1932 to June 30, 1941	13222	4284
57, Statement of Gas Purchased, Period from April 1, 1932 to June 30, 1941	13223	4285

58, Statement of Gas Revenue, Period from April 1, 1932 to June 30, 1941 and Schedule showing Detail of Sales to various Types of Customers, 1939 and 1940	13224	4287
Schedule 1, Statement of Gas Revenue, Period from April 1, 1932 to June 30, 1941	13224	4287
Schedule 2, Detail of Sales to Gas Utilities, years 1939 and 1940	13225	4289
Schedule 3, Detail of Sales to Industrial Customers, years 1939 and 1940	13227	4293
59 Statement of Gas Revenue by States, Period from April 1, 1932 to December 31, 1941	13229	4297
60, Statement showing Sales Agreements with other Gas Companies as at June 30, 1941	13230	4299
61, Study of Current and Future Trends in Commodity Prices and Wages, by David Friday	13238	4310
Graph showing Wholesale Prices from 1800 to 1940	13239	4311
Index Numbers of Wholesale Prices of Commodities by Groups	13241	4313
Commodity Price Indexes of Ten Countries	13247	4318
Statement relating to Tax Collections in the United States, from 1913 to 1942	13258	4328
Index Numbers of Wholesale Prices of all Commodities by Months, from 1890 to 1940	13263	4333
Statement relating to Wholesale Prices for Week Ended September 20, 1941	13264	4335
Graph relating to Average Weekly Earnings in Manufacturing Industries of New York State from 1914 to 1941	13266	4339
Graph relating to Average Hourly Earnings and Average Actual Hours per Week per Worker in twenty-five Manufacturing Industries from 1914 to 1941	13267	4341
Graph relating to Average Cost of Living from 1935 to 1939	13268	4343
62, Deduction from Cost of Reproduction New for Depreciation and Present Value of Plant, Property and Business as of June 30, 1941	13270	4345
Letter from P. McDonald Biddison, Consulting Engineer, to Panhandle Eastern Pipe Line Company, September 30, 1941	13271	4345
General Summary	13272	4347
63, Investors' Appraisal of the Risk of Capital in the Natural Gas Industry as compared with other Divisions of the Utility Industry, Summary of Analyses, prepared by Paul B. Coffman, Vice-President of Standard and Poors Corporation	13321	4349
Table of Contents	13322	4349
Statement of Experience and Qualifications of Paul B. Coffman	13327	4354
Investors' Appraisal of Capital Risks in Various Divisions of the Utility Industry	13348	4371
Statement A, Investors' Appraisal of Risks of Capital for the years 1937, 1938, 1939 and 1940	13351	4373

Statement A-1, Investors' Appraisal of Risks of Capital for the Interim Period of 1941, January-August, Both Inclusive.....	13352	4375
Statement B, Investors' Appraisal of Risks of Capital for the years 1937, 1938, 1939 and 1940.....	13353	4377
Statement B-1, Investors' Appraisal of Risks of Capital for the Interim Period of 1941, January-August, Both Inclusive.....	13354	4379
Statement C, Investors' Appraisal of Risks of Capital for the years 1937, 1938, 1939 and 1940.....	13355	4381
Statement C-1, Investors' Appraisal of Risks of Capital for the Interim Period of 1941, January-August, Both Inclusive.....	13356	4383
Statement D, Investors' Appraisal of Risks of Capital for the years 1937, 1938, 1939 and 1940.....	13357	4385
Statement D-1, Investors' Appraisal of Risks of Capital for the Interim Period of 1941 January-August, Both Inclusive.....	13358	4387
Statement E, Investors' Appraisal of Risks of Capital for the years 1937, 1938, 1939 and 1940.....	13359	4389
Statement E-1, Investors' Appraisal of Risks of Capital for the Interim Period of 1941, January-August, Both Inclusive.....	13360	4391
Statement F, General Information Covering each Company as to the Nature and Size of the Business and the Territory served.....	13361	4393
64, Statistics supporting Data, Exhibit 63, Appendixes A, B, and C.....	13379	4414
Appendix A, Complete List of Companies studied and Reasons for eliminating those not used to determine Investors' Appraisal of Risks of Capital.....	13380	4414
Appendix B, Securities of forty-three Natural Gas Companies considered Representative of the Industry, etc.....	13387	4426

Index, Volume X.

Appendix C, Working Papers showing the Computation of Investors' Appraisal of the Risks of Capital.....	13398	4446
Water Companies.....	13399	4447
Electric Operating Utility Companies.....	13420	4461
Manufactured and Mixed Gas Companies.....	13465	4501
Natural Gas Companies.....	13495	4521
65, Study relative to Rate of Return on Panhandle Eastern Pipe Line Company prepared by Paul B. Coffman, Vice President, Standard and Poors Corporation.....	13533	4547
Table of Contents.....	13534	4547
Chart No. 1, Main Transmission System of Panhandle Eastern Pipe Line Co. and Subsidiary.....	13542	4559
Chart No. 2, Growth of Natural Gas Industry in United States of America from 1906 to 1940.....	13548	4567
Chart No. 3, Consumption of Natural Gas in United States of America from 1919 to 1940.....	13550	4571
Chart No. 4, Revenue from Natural Gas Consumed in United States of America from 1919 to 1940.....	13552	4573

	Original Print	
Chart No. 5, Average Revenue per M. C. F. from 1929 to 1940	13554	4575
Chart No. 6, Panhandle Sales by States, vs. Industry. Consumption of Natural Gas from 1934 to 1940	13556	4577
Chart No. 7, Trends of Gross Revenue from 1934 to 1940, Panhandle vs. other Pipe Line Companies and Industry	13558	4579
Chart No. 8, Operating Ratio of Panhandle Compared with other Pipe Line Companies from 1934 to 1940	13560	4581
Chart No. 9, Trend of Revenue and Expenses of Panhandle Eastern Pipe Line Company from 1934 to 1940	13562	4583
Chart No. 10, Percent Earned on Invested Capital of Panhandle Based upon Capital Structure	13564	4585
Chart No. 11, Percent Earned on Invested Capital of Panhandle Based upon Net Property, Intangibles and Working Capital	13566	4587
Chart No. 12, Return to Common Stockholders of Pan- handle Eastern Pipe Line Company from 1934 to 1940	13568	4589
Chart No. 13, New Tax Bill will reduce Income sharply Computations based on Operations — Twelve Months ended June 30, 1941	13570	4591
Chart No. 14, Percent Earned on Invested Capital of Panhandle Eastern Pipe Line Company — as of June 30, 1941	13572	4593
Chart No. 15, Percent Earned on Invested Capital of Panhandle Eastern Pipe Line Company — as of June 30, 1941	13574	4595
Chart No. 16, Historical Costs of Debt Capital of Pan- handle Eastern Pipe Line Company — from 1930 to 1941	13576	4599
Chart No. 17, Effect of 1941 Refinancing of Panhandle Eastern Pipe Line Company	13578	4603
Chart No. 18, Historical Costs of Preferred Stock Capital of Panhandle Eastern Pipe Line Company from 1937 to 1941	13580	4605
Chart No. 19, Earnings — Price Ratios of Natural Gas Pipe Line Common Stocks from 1937 to 1940	13582	4607
Chart No. 20, Current Earnings — Price Ratios of Natural Gas Pipe Line Common Stocks	13584	4609
Chart No. 21, Cost of Financing Northern Natural Gas Company Common Stock — Offered to Public on September 10, 1941	13586	4613
Chart No. 22, Estimated Current Cost of Financing Com- mon Stock of Panhandle Eastern Pipe Line Company	13588	4615
Chart No. 23, Continuing Growth of Panhandle System Indicates Future Needs for New Capital	13590	4617
Chart No. 24, Panhandle Eastern Pipe Line Company In- vested Capital as of June 30, 1941	13592	4621
Chart No. 25, Preferred Stock Unusual in Natural Gas Pipe Line Companies	13594	4623
Chart No. 26, Earnings Necessary to Maintain Credit Position of Panhandle Eastern Pipe Line Company	13596	4625
Chart No. 27, Earnings Necessary to Maintain Credit Position of Panhandle Eastern Pipe Line Company	13598	4627
Chart No. 28, Overall Cost of Capital to Panhandle East- ern Based on Ideal Capital Structure	13600	4629

	Original Print	
Chart No. 29, Dollars needed Annually by Panhandle for Operations and Maintenance.....	13602	4633
Chart No. 30, Dollars needed Annually by Panhandle for Taxes.....	13604	4637
Chart No. 31, Dollars needed Annually by Panhandle to return Capital to Investors when Gas Reserves are Exhausted.....	13606	4639
Chart No. 32, Dollars needed Annually by Panhandle for current Capital Requirements — Bonds.....	13608	4641
Chart No. 33, Dollars needed Annually by Panhandle for current Capital Requirements — Preferred Stock.....	13610	4643
Chart No. 34, Dollars needed Annually by Panhandle for current Capital Requirements — Common Stock.....	13612	4645
Chart No. 35, Dollars needed Annually by Panhandle for total current Capital Requirements — Total Invested Capital.....	13614	4647
Chart No. 36, Dollars needed Annually by Panhandle to provide Service to Customers, a Fair Return to Investors and restore Invested Capital when Gas Reserves are Exhausted.....	13616	4649
Chart No. 37, Dollars needed Annually by Panhandle to Provide Service to Customers, a Fair Return to Investors and restore Invested Capital when Gas Reserves are Exhausted.....	13618	4651
Table for Chart No. 2, Growth of Natural Gas in the United States of America for the years 1906 to 1940, Inclusive.....	13619	4653
Table for Chart No. 3, Consumption of Natural Gas in the United States of America for the years 1919 to 1940, Inclusive.....	13620	4655
Table for Chart No. 4, Revenue from Natural Gas Consumed in the United States of America for the years 1919 to 1940, Inclusive.....	13621	4657
Table for Chart No. 5, Average Revenue per M. C. F. from Natural Gas Consumed in United States of America at Points of Consumption.....	13622	4659
Table for Chart No. 6, Natural Gas Sales by States for the years 1934 to 1940, Inclusive.....	13623	4661
Table for Chart No. 7, Trend of Gross Revenue, Panhandle Eastern Pipe Line Company vs. Other Pipe Line Companies and the Natural Gas Industry, 1934 to 1940 Both Inclusive.....	13624	4663
Table for Chart No. 8, Operating Ratio of Panhandle Eastern Pipe Line Company compared with other Pipe Line Companies exclusive of Taxes, 1934 to 1940.....	13625	4665
Table for Chart No. 9, Panhandle Eastern Pipe Line Company, Trend of Revenue and Expenses.....	13627	4669
Table for Chart No. 10, Percent Earned on Invested Capital, based upon Capital Structure.....	13628	4671
Table for Chart No. 11, Percent Earned on Invested Capital, based upon Net Property, Intangibles and Working Capital.....	13629	4673
Table for Chart No. 12, Return to Common Stockholders 1934 to 1940 Both Inclusive.....	13630	4675

Table for Chart No. 13, Consolidated Statement of Profit and Loss for the twelve months ended June 30, 1941	13631	4677
Table for Chart No. 14, Percent Earned on Invested Capital — twelve months ended June 30, 1941	13632	4679
Table for Chart No. 15, Percent Earned on Invested Capital in the twelve months ended June 30, 1941	13633	4681
Table for Chart No. 16, Computation of Weighted Average Cost Ratio of all Bond Issues 1930 — June 30, 1941	13634	4683
Table for Chart No. 17, Projection of Average Interest Cost, Debt Retirement and Amounts to be outstanding of Debt issued in the 1941 Refinancing	13639	4693
Table for Chart No. 18, Preferred Stock	13640	4695
Table for Chart No. 19, Earnings — Price Ratios on Natural Gas Pipe Line Common Stocks from 1937 to 1940	13641	4697
Table for Chart No. 20, Current Earnings — Price Ratios on Natural Gas Pipe Line Common Stocks	13642	4699
Table for Chart No. 21, Data regarding Public Offering of 355,250 Shares Northern Natural Gas Company Common Stock	13643	4701
Table for Chart No. 23, Statistics of Growth from 1936 to 1940	13644	4703
Table for Chart No. 25, Ratio of Preferred Stock to total Capitalization in Natural Gas Pipe Line Companies as of December 31, 1940	13645	4705
Table for Chart No. 26, Earnings Necessary to Maintain Credit Position based on Invested Capital as of June 30, 1941	13646	4707
Table for Chart No. 27, Earnings Necessary to Maintain Credit Position, etc.	13647	4709
Table for Charts Nos. 29 to 36, Inclusive, Dollars needed Annually to provide Service to Customers, a Fair Return to Investors and Return of Invested Capital when Reserves are Exhausted	13648	4711
Table for Chart No. 37, Dollars needed Annually to provide Service to Customers, a Fair Return to Investors and Return of Invested Capital when Reserves are Exhausted	13649	4713
69, Statement showing Amount of Depreciation on Book Cost of Property as of June 30, 1941	13709	4715
70, Reproduction Cost New of Plant, Property and Business as of June 30, 1941 (Determined from Valuation of September 30, 1938 by addition of Net Property Additions, plus Items of Working Capital, Value of Gas Purchase Contracts and Cost of Business Development from Valuation of June 30, 1941)	13711	4719
71, Valuation of Property, Plant and Equipment, September 30, 1938	13712	4719
Letter from P. McDonald Biddison, Consulting Engineer, to Panhandle Eastern Pipe Line Company, October 14, 1938	13713	4719

Statement relating to Appraisal of Property of Panhandle Eastern Pipe Line Company as of September 30, 1938	13719	4721
72. Statement of Net Additions to Gas Plant per Books from Oct. 1, 1938 to June 30, 1941	14178	4723
74. Working Capital	14198	4724
Table I, Total Additional Necessary Materials and Supplies by Departments	14198	4724
Table II, Additional Necessary Materials and Supplies by Departments, Classified to show the Aggregate Supplies	14199	4724
Table III, Summary of Minimum Reasonable Amounts of Working Capital Currently Needed	14200	4725
Table IV, Total Cash, Prepayments, and Materials and Supplies Actually Maintained by the Company at Certain Dates in the Past	14201	4725
75. Natural Gas Supply, Value of Gas Reserves and Wells, February 1, 1937	14202	4726
Letter Ralph E. Davis, Inc., Engineers, to Panhandle Eastern Pipe Line Company and others, February 10, 1937	14203	4726
Table No. 2, Valuation of Producing and Proven Leases in Producing Area of Amarillo Field	14227	4744
Table No. 3, Valuation of Producing and Proven Leases in Producing Area of Hugoton Field	14228	4745
Table No. 8, Classification of Acreage Under Lease, February 1, 1937	14233	4745
76. Panhandle Eastern Pipe Line Company Natural Gas Supply	14243	4746
Letter, Ralph E. Davis, Inc., Engineers, to Board of Directors of Panhandle Eastern Pipe Line Company, November 12, 1940	14244	4746
Summary of Acreage in Amarillo and Hugoton Fields	14248	4751
77. Description of Physical Property of Michigan Gas Transmission Corporation	14251	4753
Testimony of George S. Young	14252	4753
Schedule 1, Compressor Stations	14272	4770
Schedule 2, List of Communities receiving Service from Public Utilities to whom Michigan Gas Transmission Corporation sells Gas Purchased from Panhandle Eastern Pipe Line Company, Population and Number of Customers as of June 30, 1941	14274	4771
Schedule 3, List of Industrial Consumers receiving Service on an Interruptible Basis indirectly from Michigan Gas Transmission Corporation System, June 30, 1941	14277	4779
Schedule 8, Michigan Gas Transmission Corporation Summary of Miles of Pipe by Sizes, June 30, 1941	14295	4781
79. Comparison of Daily provided Capacity to deliver Firm Gas with Maximum Daily Delivery of Firm Gas from System of Michigan Gas Transmission Corporation.	14311	4783
79-A, Comparison of Daily provided Capacity to Deliver Firm Gas with Maximum Daily Delivery of Firm Gas and total delivery of Gas from the Pipe Lines owned or operated by Michigan Gas Transmission Corporation for the Winter Period of 1941-1942 to February 27, 1942	14312	4785

79-B, Total Delivery of Gas from Pipe Lines owned and operated by Michigan Gas Transmission Corporation on Days on which the Delivery of Firm Gas from System was the Maximum	14313	4787
80, Report of Inspection of Equipment in the Compressor Stations of the Michigan Gas Transmission Corporation by H. C. Lehm	14314	4789
81, Depreciation Study, Michigan Gas Transmission Corporation by H. S. Riddle	14321	4794
Letter, H. S. Riddle, Gas Engineering Department, to G. S. Young, Vice President, of Michigan Gas Transmission Corporation, November 10, 1941	14322	4794
Summary of Inspection Data	14323	4795
82, Accrued Depreciation on Compressor Station Structure, measuring and regulating Station Structures and Equipment and, other Transmission Structures and general Equipment as of June 30, 1941 by Francis S. Haberly	14369	4796
83, Reproduction Cost new of Plant and Property of Michigan Gas Transmission Corporation as of June 30, 1941 by Francis S. Haberly	14375	4801
Letter Francis S. Haberly, Engineer, to G. S. Young, Vice President, Michigan Gas Transmission Corporation, October 27, 1941	14377	4801
Table of Contents	14378	4802
Statement of Francis S. Haberly	14379	4802
Summary	14389	4810
Reconciliation of Original Cost and of Reproduction Cost to reflect Changes due to Reclassification	14390	4811
Compressor Station Structures and Improvements	14391	4813
All Stations	14391	4813
Montezuma Compressor Station	14392	4813
Zionsville Compressor Station	14398	4818
Edgerton Compressor Station	14402	4821
Other Transmission System Structures and Improvements	14405	4824
All Locations	14405	4824
Montezuma Compressor Station	14406	4824
Zionsville Compressor Station	14407	4825
Edgerton Compressor Station	14408	4826
Mains	14409	4826
Compressor Station Equipment	14416	4831
All Stations	14416	4831
Montezuma Compressor Station	14417	4831
Zionsville Compressor Station	14427	4839
Edgerton Compressor Station	14433	4844
Measuring and Regulating Station Equipment	14437	4847
General Equipment	14438	4848
Office Furniture and Fixtures	14439	4848
Transportation Equipment	14440	4849
Scores Equipment	14441	4849
Tools and Work Equipment	14442	4849
84, Reproduction Cost new less Depreciation of Michigan Gas Transmission Corporation as of June 30, 1941 by Francis S. Haberly	14443	4850

	Original	Print
Summary	14444	4850
Compressor Station Structures and Improvements	14445	4851
Measuring and Regulating Station Structures	14446	4852
Other Transmission System Structures	14447	4852

Index, Volume XI.

Mains	14448	4853
Compressor Station Equipment	14449	4853
Measuring and Regulating Station Equipment	14450	4854
General Equipment	14451	4855
87, Materials and Supplies Restatement of Cost of Major Items as of June 30, 1941, Michigan Gas Transmission Corporation by Francis S. Haberly	14466	4856
Materials and Supplies	14467	4856
88, Michigan Gas Transmission Corporation — Comparative Balance Sheets, per Books as at December 31, 1936 to 1940, Inclusive, and June 30, 1941	14475	4863
89, Michigan Gas Transmission Corporation Statement showing earned Surplus per Books for the Ten Months ended December 31, 1936, years 1937 to 1940, inclusive, year and six months ended June 30, 1941	14477	4867
90, Michigan Gas Transmission Corporation — Statement showing Capital Surplus, per books, for the Ten Months ended December 31, 1936, years 1937 to 1940, inclusive, year and six months ended June 30, 1941	14478	4869
91, Michigan Gas Transmission Corporation — Preliminary Report on Original Cost Studies by Central Service Corporation	14479	4871
Statement A, Outline of Origin and Development	14489	4878
Statement A-1, Common Stock issued and Outstanding at January 1, 1940 and June 30, 1941	14492	4881
Statement B, Statement showing Acquisition by Reporting Company or Predecessors of Gas Operating Unit or System, etc.	14493	4883
Statement D, Statement relating to Gas Plant as of January 1, 1940, etc.	14494	4885
Statement E, Statement showing Summary of Adjustment relating to Gas Plant, etc.	14495	4886
Statement F, Statement relating to Gas Plant as of January 1, 1940, etc.	14496	4887
Statement G, Statement relating to Balance Sheet as of January 1, 1940, etc.	14498	4891
Statement H, Statement relating to Suggested Plan for Depreciation, etc.	14499	4893
Statement I, Statistical Information Relative to Gas Plant at June 30, 1941	14500	4893
92, Michigan Gas Transmission Corporation Statement showing Original Cost Depreciated to present Conditions as at June 30, 1941 and observed Depreciation as at June 30, 1941	14507	4903

93, Michigan Gas Transmission Corporation — Statement of Contributions made to Customers for Business Development for the years 1936, 1937 and five months ended May 31, 1938	14508	4905
94, Michigan Gas Transmission Corporation Statement showing working Capital as of June 30, 1941	14510	4908
95, Michigan Gas Transmission Corporation — Estimated Cost of Completing work in Progress at June 30, 1941 and Estimated Gross Income to be derived from the Completed Projects	14517	4919
97, Michigan Gas Transmission Corporation — Variation in Purchase Power of Dollar — Related to Gas Plant	14519	4921
Graph relating to Variation in Purchasing Power of the Dollar spent for Main Compressor Units	14522	4923
Graph relating to Variation in Purchasing Power of the Dollar spent for Steel Pipe	14523	4925
Graph relating to Variation in Purchasing Power of the Dollar spent for Station Structure Materials	14524	4927
Graph relating to Variation in Purchasing Power of the Dollar spent for Station Structure Labor	14525	4929
Graph relating to Variation in Purchasing Power of the Dollar spent for Station Equipment Labor	14526	4931
Graph relating to Variation in Purchasing Power of the Dollar spent for Mains Installations	14527	4933
Statement relating to Variation in Purchasing Power of the Dollar as related to "Gas Plant"	14528	4935
99, Michigan Gas Transmission Corporation — Statement of Income and Expense per books for years ended December 31, 1936 to 1940, inclusive, five months ended June 30, 1941 and six months ended June 30, 1941 and December 31, 1940	14530	4937
100, Michigan Gas Transmission Corporation — Statement of Income and Expense per books and after Adjustments and redistributions necessary to reflect the 2-6 months Period per books on an annual basis, for six months ended December 31, 1940 and June 30, 1941 and for twelve months ended June 30, 1941	14533	4943
101, Michigan Gas Transmission Corporation — Comparative Statement of Operating Revenues, for years ended December 31, 1936 to 1940, inclusive, twelve months ended June 30, 1941 and six months ended June 30, 1941 and December 31, 1940	14537	4951
102, Michigan Gas Transmission Corporation — Operation and Maintenance Expense per books for the twelve months ended June 30, 1941	14538	4953
103, Michigan Gas Transmission Corporation — Statement showing Gas Sales, Gas Transported, Gas used, by Company, Line Losses and Gas Purchased for the years ended December 31, 1936 to 1940, inclusive, twelve months ended June 30, 1941 and December 31, 1940	14540	4957
106, Registration Statement of Panhandle Eastern Pipe Line Company No. 2-4597, filed with the Securities & Exchange Commission November 18, 1940, Excerpts from	14548	4959

	Original	Print
Cover and Pages 1 to 4	14548	4959
Pages 45 and 46	14593	4969
Pages 60 and 61	14608	4973
Page S-1, Auditor's Certificate	14626	4977
Pages S-3 to S-7, Balance Sheet as of December 31, 1940	14628	4979
Pages S-17 to S-24, Intangible Assets, etc	14642	4989
107, Report A-11488 of the Committee on Stock List, New York Stock Exchange, application for Listing of the first Mortgage and First Lien 3% Bonds, Series B due November 1, 1960 of Panhandle Eastern Pipe Line Company	14651	5005
Page 1	14651	5005
108, Letter of P. McDonald Biddison re Provision for Retirements, Depletion and Amortization for year 1938	14732	5006
109, Letter of P. McDonald Biddison re Provision for Retirements, Depletion and Amortization for year 1939	14733	5007
110, Letter of P. McDonald Biddison re Provision for Retirements, Depletion and Amortization for year 1940	14734	5008
111, Letter of P. McDonald Biddison re Provision for Retirements, Depletion and Amortization for year 1941	14735	5009
112, Table of Subsidiary Companies of Panhandle Eastern Pipe Line Company	14736	5010
131, Future Division of Production between Fields Considering a reasonable expected Load Increase	14768	5015
132, Future Division of Production between Fields without Consideration for increased Loads	14769	5017
137, Acres used in Determining Weighted Average Pressures of Texas Panhandle Field	14783	5018
138, Dry Gas Production and Pressure Decline — Texas Panhandle Field	14784	5019
139, Estimated Intake Pressures at Sneed Compressor Station	14785	5020
140, Estimated Average Working Pressures at Well head for "Group Areas" shown on Exhibit 46	14786	5021
141, Annual and Cumulative Production from Panhandle Field, Texas	14787	5023
142, Summary of Cost of Gas Produced and Purchased — basic Load for the years 1940-46, inclusive	14789	5026
Schedule 1, Summary of Cost of Gas Produced and Purchased per M. C. F. by Fields — Basic Load for the years 1940 to 1946 inclusive	14790	5027
Schedule 2, Cost of Gas Purchased per M. C. F. By Fields — Basic Load for the years 1940 to 1946 inclusive	14791	5027
Schedule 3, Production Costs per M. C. F. Produced by Fields — Basic Load for the years 1940 to 1946 inclusive	14792	5031
Schedule 4, Transportation Costs per M. C. F. Produced by Fields — Basic Load for the years 1940 to 1946 inclusive	14793	5033
Schedule 5, Summary of Production and Transportation Costs per M. C. F. Produced by Fields — Basic Load for the years 1940 to 1946 inclusive	14794	5035

143. Summary of Cost of Gas Produced and Purchased — Estimated Future Load for the years 1940 to 1946, inclusive	14795	5036
Schedule 1, Summary of Cost of Gas Produced per M. C. F. by Fields — Estimated future Load for the years 1940 to 1946 inclusive	14796	5037
Schedule 2, Cost of Gas Purchased per M. C. F. by Fields — Estimated Future Load for the years 1940 to 1946 inclusive	14797	5039
Schedule 3, Production Costs per M. C. F. Produced by Fields — Estimated Future Load for the years 1940 to 1946 inclusive	14798	5041
Schedule 4, Transportation Costs per M. C. F. Produced by Fields — Estimated Future Load for the years 1940 to 1946 inclusive	14799	5043
Schedule 5, Summary of Production and Transportation Costs per M. C. F. Produced by Fields — Estimated Future Load for the years 1940 to 1946 inclusive	14800	5045
145. Panhandle Eastern Pipe Line Company — Compiled Registration Statement No. 2-4919 filed with the Securities & Exchange Commission December 24, 1941, Excerpts from	14824	5047
Cover and following Page	14824	5047
Pages 2 to 5	14827	5051
Pages 9 to 20	14834	5059
Page S-1, Auditor's Certificate	14924	5083
Pages S-3 to S-9, Balance Sheet as of September 30, 1941	14926	5085
Pages S-18 to S-21, Reserves for Depreciation, etc.	14941	5099
147. Holding Company Act Release No. 3286, January 23, 1942 — Findings and Opinion of the Securities & Exchange Commission in the Matter of Columbia Gas and Electric Corporation, et al	15091	5107
Order	15114	5140
149. Statement showing Investment by Owners and Long Term Creditors at June 30, 1941, Panhandle Eastern Pipe Line Company	15117	5143
150. Financial Data of Common Stock Issues of Electric and Gas Utilities, Years 1935 to 1946, inclusive	15118	5145
151. Earnings — Price Ratios of Common Stocks in Various Divisions of the Utility Industry	15122	5153
152. Estimate of Federal Income and Excess Profits Taxes, applying Rates levied in the Revenue Act of 1941 to Net Income for the Year ended June 30, 1941, Panhandle Eastern Pipe Line Company	15131	5171
153. Statement of Cost of Business Development Period from April 1, 1932 to June 30, 1941, Panhandle Eastern Pipe Line Company	15135	5177
157-A. Agreement between Panhandle Eastern Pipe Line Company and Columbia Gas and Electric Corporation and Columbia Oil and Gasoline Corporation dated January 31, 1936 (Exhibit H-6)	15227	5183
157-B. Agreement between Columbia Oil and Gasoline Corporation and Columbia Gas and Electric Corporation and		

	Original	Printed
Panhandle Eastern Pipe Line Company and Henry T. Bush and C. Ray Phillips, receivers of Missouri-Kansas Pipe Line Company, dated as of June 1, 1936 (Exhibit H-9)	15237	5183
Exhibit A, General Release	15261	5200
Exhibit B, General Release to Receivers	15255	5202
Exhibit C, Release of Claim	15256	5203
157, C. Bofink Volume, containing Offer dated January 31, 1936 of Columbia Gas & Electric Corporation and Columbia Oil and Gasoline Corporation to the Receivers of Missouri-Kansas Pipe Line Company, Extension dated March 5, 1936, Modification dated April 22, 1936 and Acceptance dated April 29, 1936 (Exhibit I-2)	15258	5205
Letters	15266	5220
158, Statement showing Gas Revenue from Indiana Gas Transmission Corporation and Michigan Gas Transmission Corporation from November 1931 to November 1941, inclusive, Panhandle Eastern Pipe Line Company	15280	5233
160, Purchase Agreement dated February 2, 1942 between Panhandle Eastern Pipe Line Company and Gloré, Forgan & Company and Kidder, Peabody & Company	15285	5241

Index, Volume XII.

161, Estimated Main Line Sales and Revenues, years 1941-1946, inclusive, Panhandle Eastern Pipe Line Company	15300	5271
162, Ten Years' Estimate (1941-1951) of Sales to Detroit and other Areas and Types of Sale	15301	5273
163, Financial Statement of Michigan Gas Transmission Corporation for Period ended December 31, 1941	15312	5295
Balance Sheet as of December 31, 1941	15313	5297
Assets	15314	5299
Liabilities	15315	5301
Income Statement	15317	5305
Gas	15318	5307
Non-Utility	15320	5311
Other Income	15321	5313
Other Deductions	15322	5315
Surplus	15323	5317
Gas Expenses	15335	5341
Statistical Report	15339	5349
Fixed Capital Expenditure, Report	15343	5357
164, Supplementary Statement of Financial Statement, Exhibit 163	15353	5377
165, Operating Budget of Michigan Gas Transmission Corporation for the year 1942, Excerpt from	15355	5381
Cover	15355	5381
Pages 3 to 53	15357	5383
Income Statement	15357	5383
Gas	15358	5385
Other Deductions	15359	5387
166, Statements showing Gas Purchase and Sales Transactions between Panhandle Eastern Pipe Line Company and Subsidiaries	15373	5413

167, Statement showing Checks of Michigan Consolidated Gas Company in favor of Michigan Gas Transmission Corporation drawn on National Bank of Detroit	15374	5415
169, Statement showing Percentage Increase or Decrease of Sales of Natural Gas of Michigan Gas Transmission Corporation for year 1937 to 1941, inclusive, to other affiliates	15376	5417
170, Certificate setting forth the Designation and certain of the Terms of the 5.60% cumulative Preferred Stock of Panhandle Eastern Pipe Line Company filed February 3, 1942, in Delaware	15378	5421
171, Certificate of Purchase and Retirement of Class A Preferred Stock of Panhandle Eastern Pipe Line Company filed February 14, 1942 in Delaware	15393	5434
172, Balance Sheets per Books Panhandle Eastern Pipe Line Company and Subsidiary Companies, as at each December 31, 1930 through 1941	15397	5437
173, Income Statement per Books, Period from April 1, 1932 to December 31, 1941, Panhandle Eastern Pipe Line Company and Subsidiary Companies	15400	5443
174, Earned Surplus per Books, Period from Commencement of Operations to December 31, 1941, Panhandle Eastern Pipe Line Company and Subsidiary Companies	15402	5447
175, Capital Surplus per Books, Period from September 1, 1930 to December 31, 1941, Panhandle Eastern Pipe Line Company and Subsidiary Companies	15404	5451
176, Gas Plant — Panhandle Eastern Pipe Line Company and Subsidiary Companies as at each December 31, 1930 through 1941	15405	5453
177, Statement of Gas Produced, Period from April 1, 1932 to December 31, 1941, Panhandle Eastern Pipe Line Company and Subsidiary Companies	15407	5456
178, Statement of Gas Purchased from Period April 1, 1932 to December 31, 1941, Panhandle Eastern Pipe Line Company and Subsidiary Companies	15408	5457
179, Statement of Gas Revenue, Period from April 1, 1932 to December 31, 1941, Panhandle Eastern Pipe Line Company and Subsidiary Companies	15409	5459
180, Statement of Gas Revenue by States, Period from April 1, 1932 to December 31, 1941, Panhandle Eastern Pipe Line Company and Subsidiary Companies	15410	5461
181, Net Additions to Gas Plant per Books October 1, 1938 to December 31, 1941, Panhandle Eastern Pipe Line Company and Subsidiary Companies	15411	5462
182, Comparative Statement of Depreciation, Depletion and Amortization of Unoperated leases authorized by Board of Directors and the amounts booked for the years 1937, 1938, 1940 and 1941, Panhandle Eastern Pipe Line Company and Subsidiary Companies	15412	5463
183, Statement showing Amount of Depreciation claimed in Federal Income Tax Returns and Settlement Basis for the nine months ended December 31, 1932 and the years 1933 to 1940, inclusive, Panhandle Eastern Pipe Line Company and Subsidiary Companies	15413	5463

184. Comparative Statement of State, Local and Miscellaneous Federal Taxes Paid with the Amounts Accrued years 1936 to 1940, inclusive	15414	5464
185. Statement of Taxes Paid for the years 1936 through 1940, Panhandle Eastern Pipe Line Company and Subsidiary Companies	15415	5465
186. Reconciliation Federal Income and Federal Excess Profits Taxes Paid with Amounts accrued years 1936 through 1940, Panhandle Eastern Pipe Line Company and Subsidiary Companies	15416	5467
187. Panhandle Eastern Pipe Line Company and Subsidiary Companies' Statements and Copies of Contracts with Missouri Power and Light Company, Illinois Iowa Power Company, Caterpillar Tractor Company, Keystone Steel & Wire Company, R. Herschel Manufacturing Company and Peoria Malleable Castings Company, Excerpts from Page 1, Statement concerning Contract with Missouri Power and Light Company	15417	5469
Page 2, Statement concerning Contract with Illinois Iowa Power Company	15417	5469
Page 3, Statement concerning Contract with Caterpillar Tractor Company	15430	5469
Page 4, Statement concerning Contract with Keystone Steel and Wire Company	15442	5470
Page 5, Statement concerning Contract with R. Herschel Manufacturing Company	15445	5471
Page 6, Statement concerning Contract with Peoria Malleable Castings Company	15449	5472
188. Panhandle Eastern Pipe Line Company Annual Report for the year 1940, Excerpts from	15452	5472
Pages 3 to 6, Annual Report for 1940	15458	5473
189. Panhandle Eastern Pipe Line Company Annual Report for the year 1941, Excerpts from	15458	5473
Pages 3 to 8, Annual Report for 1941	15472	5476
190. Comparative Statement of Operating and Maintenance Expenses year ended December 31, 1940 and 1941, Panhandle Eastern Pipe Line Company and Subsidiary Companies	15472	5476
191. Reconciliation of Net Income per books with Net Income per Federal Income Tax Return for the year 1939, Panhandle Eastern Pipe Line Company	15486	5483
192. Reconciliation of Net Income per books with Net Income per Federal Income Tax Return for the year 1940, Panhandle Eastern Pipe Line Company	15490	5489
193. Analysis of Reserve for Depreciation of Gas Plant, years ended December 31, 1932 through 1940 and six Months ended June 30, 1941, Panhandle Eastern Pipe Line Company and Subsidiary Companies	15491	5491
194. Panhandle Eastern Pipe Line Company and Subsidiary Companies pro forma Consolidated Balance Sheet as of December 31, 1941 giving effect to financing Transactions consummated on February 6, 1942 and Acquisition on that Date of Capital Stock and Debt of Michigan Gas	15492	5493

Transmission Corporation, and Indiana Gas Distribution Corporation, and Purchase of Certain Property of Ohio Fuel Gas Company	15494	5499
195, Panhandle Eastern Pipe Line Company and Subsidiary Companies pro forma Consolidated Income Account (Note A) for the year ended December 31, 1941	15499	5505
196, Panhandle Eastern Pipe Line Company and Subsidiary Companies pro forma Consolidated Income Account (Note A) for the year ended December 31, 1941 as adjusted to give the Effect to Federal Income and Federal Excess Profits Tax Rates proposed in Recommendation of Secretary of Treasury Morgenthau on March 3, 1942 before House, Ways and Means Committee	15502	5509
197, Panhandle Eastern Pipe Line Company and Subsidiary Companies Balance Sheet per books February 28, 1942	15506	5513
198, Panhandle Eastern Pipe Line Company and Subsidiary Companies pro forma Consolidated Income Account (Note A) for the twelve months ended February 28, 1942	15510	5519
199, Panhandle Eastern Pipe Line Company and Subsidiary Companies pro forma Consolidated Income Account (Note A) for the twelve Months ended February 28, 1942 as adjusted to give effect to Federal Income and Federal Excess Profits Tax Rates proposed in Recommendation of Secretary of Treasury Morgenthau on March 3, 1942 before House, Ways and Means Committee	15513	5523
200, Panhandle Eastern Pipe Line Company and Subsidiary Companies (including Michigan Gas Transmission Corporation and Indiana Gas Distribution Corporation) Comparative Statement of Gas Plant as of December 31, 1939, December 31, 1940, June 30, 1941, December 31, 1941 and February 28, 1942	15517	5527
201, Michigan Gas Transmission Corporation Gas Plant, as at each December 31, 1934 through 1941	15519	5531
202, Panhandle Eastern Pipe Line Company and Subsidiary Companies, including Michigan Gas Transmission Corporation and Indiana Gas Distribution Corporation, Statement of Estimated Federal Income and Excess Profits Taxes for the year 1941 (based on the Revenue Act of 1941)	15520	5533
203, Panhandle Eastern Pipe Line Company and Subsidiary Companies Statement of Operation and Maintenance Expense year 1941 (restated to include Michigan Gas Transmission Corporation and Indiana Gas Distribution Corporation for entire year)	15525	5541
204, Panhandle Eastern Pipe Line Company and Subsidiary Companies 1942 Construction and Retirement Budgets Summary by Companies	15529	5545
205, Panhandle Eastern Pipe Line Company and Subsidiary Companies Statement of Certain Estimated Construction Expenditures for the year 1942	15537	5556
208, Financial Statement of Panhandle Eastern Pipe Line Company and Subsidiary Companies for the period ended December 31, 1941	15783	5556

	Original Price	
Financial Statement of Panhandle Eastern Pipe Line Company and Subsidiary Companies	15783	5556
Financial Statement of Illinois Natural Gas Company	15822	5600

Index, Volume XIII.

Financial Statement of Panhandle Eastern Pipe Line Company	15838	5630
Statistical Report of Panhandle Eastern Pipe Line Company and Subsidiary Companies	15868	5688
209, Letter of Panhandle Eastern Pipe Line Company to Detroit City Gas Company dated March 30, 1936 designating the Office to which the latter Company should make Payment for Gas delivered pursuant to Contract of August 31, 1935	15899	5748
210, Index Numbers of Wholesale Prices of Commodities by Groups (1926 = 100)	15901	5750
211, U. S. Department of Labor, Bureau of Labor Statistics Release of March 26, 1942 Wholesale Prices for the Week ended March 21, 1942	15902	5751
212, U. S. Department of Labor, Bureau of Labor Statistics, "Index Numbers of Wholesale Prices of All Commodities by Months, from 1890 to 1940 (1926 = 100)"	15904	5755
213, Table showing Average Hourly Earnings and Average Hours per Week per Wage Earner in twenty-five Manufacturing Industries from 1914 to 1942	15905	5757
214, Graph showing Average Hourly Earnings and Average actual Hours per Week per Worker in twenty-five Manufacturing Industries from 1914 to 1942	15912	5765
215, Table showing "Employment, Payrolls and Average Weekly Earnings in Representative New York State Factories, from 1914 to 1941 employment (Index Numbers with Average from 1925 to 1927 as 100)"	15913	5767
216, Indexes of Wholesale Prices and Cost of Living for certain months from 1913 to 1942 (1935-1939 = 100)	15914	5769
217, Graph showing Indexes of Wholesale Prices and Cost of Living from 1913 to 1941	15916	5771
218, Testimony of Mr. Joe D. Creveling before the Securities and Exchange Commission on November 29, 1941, in the Matter of Columbia Gas & Electric Corporation, et al., File No. 59-33, etc.	15917	5773
219, Panhandle Eastern Pipe Line Company Gas Sales and Purchase Contracts, Copy of Report by Bureau of Internal Revenue and Related Correspondence	15931	5783
Exhibit A, Statement relating to Comparison of Values of Assets transferred to Panhandle Eastern Pipe Line Company by Missouri-Kansas Pipe Line Company, etc.	15937	5789
Exhibit B, Schedule showing Sales of Various Units of Pipe Line Construction sold by Slappey, Maddin and Parish Gas Company, etc.	15938	5790
Letter of Leith V. Watkins, Secretary-Controller, of Panhandle Eastern Pipe Line Company to N. F. Paxton, Assistant Secretary, Panhandle Eastern Pipe Line Company, November 7, 1941	15940	5792

Waiver of Restriction on Assessment and Collection of Deficiency in Tax and Acceptance of Overassessment	15942	5794
Letter of J. P. Wenchel, Chief Counsel, of Treasury De- partment to Panhandle Eastern Pipe Line Company, April 11, 1940	15944	5795
Letter of Leith V. Watkins, Secretary-Controller, of Panhandle Eastern Pipe Line Company to J. P. Wenchel, Chief Counsel, for Treasury Department, August 21, 1940	15947	5798
Letter of J. P. Wenchel, Chief Counsel, of Treasury Department to Panhandle Eastern Pipe Line Company, October 3, 1940	15954	5811
Letter of Leith V. Watkins, Secretary-Controller, of Pan- handle Eastern Pipe Line Company to J. P. Wenchel, Chief Counsel, for Treasury Department, February 24, 1941	15956	5812
220, Panhandle Eastern Pipe Line Company Excerpts from Minutes of Meetings of Board of Directors relating to provisions for Depreciation, Depletion, and Amortization	15962	5818
Minutes of February 24, 1942	15963	5818
Minutes of January 25, 1941	15964	5818
Minutes of December 14, 1939	15965	5819
Minutes of December 22, 1937	15966	5820
Minutes of February 13, 1936	15967	5820
Minutes of February 15, 1933	15970	5821
Minutes of May 5, 1932	15972	5830
221, Panhandle Eastern Pipe Line Company and Subsidiary Companies Computation of working Capital Requirement	15975	5832
222, Panhandle Eastern Pipe Line Company and Subsidiary Companies Computation of Average return Earned on Net Investment for the period April 1, 1932 to December 31, 1941	15980	5835
222-A, Panhandle Eastern Pipe Line Company and Sub- sidiary Companies Comparison of Average Return Earned on Net Investment for the periods April 1, 1932 to Decem- ber 31, 1936, and January 1, 1937 to December 31, 1941	15982	5838
223, Panhandle Eastern Pipe Line Company and Subsidiary Companies substitute Estimate (less economic) of Addi- tional Capital Expenditures South and West of Liberal Compressor Station required to meet Peak-day Sales of 307,000 M. C. F., 1942	15983	5839
224, Panhandle Eastern Pipe Line Company and Subsidiary Companies substitute Estimate (less economic) of Addi- tional Capital Expenditures South and West of Liberal Compressor Station required to meet Peak-day Sales of 338,000, M. C. F., 1942	15984	5840
225, Panhandle Eastern Pipe Line Company and Subsidiary Companies Estimate of Operation and Maintenance Costs South and West of Liberal Compressor Station, 307,000 M. C. F. Continuous Daily Sales Capacity Operation at 70% Capacity Factor	15985	5841
226, Panhandle Eastern Pipe Line Company and Subsidiary Companies Estimate of Operation and Maintenance Costs		

South and West of Liberal Compressor Stations, 307,000 M. C. F. Continuous Daily Sales Capacity Operation at 90% Capacity Factor.....	15987	5845
227, Panhandle Eastern Pipe Line Company and Subsidiary Companies Estimate of Operation and Maintenance Costs South and West of Liberal Compressor Station, 338,000 M. C. F. Continuous Daily Sales Capacity Operation at 70% Capacity Factor.....	15989	5849
228, Panhandle Eastern Pipe Line Company and Subsidiary Companies Estimate of Operation and Maintenance Costs South and West of Liberal Compressor Station, 338,000 M. C. F. Continuous Daily Sales Capacity Operation at 90% Capacity Factor.....	15991	5853
229, Capacity Study April 7, 1942 Continuous Daily Delivery Capacity — 307,900 M. C. F.	15993	5857
230, Capacity Study April 7, 1942 completely looped and economically powered Main Line System with Economic Production Transmission Expenditures	15998	5862
231, Capacity Study April 7, 1942 revised completely looped and economically powered Main Line System with less Economic Production-Transmission Expenditures ..	16003	5867
232, Michigan Gas Transmission Corporation Computation of Average Return Earned on Net Investment for the period March 1, 1936 to December 31, 1941	16008	5873
233, Prospectus Panhandle Eastern Pipe Line Company \$10,000,000 First Mortgage and First Lien 3% Bonds, Series C, due January 1, 1962, and 150,000 shares 5.00% Cumulative Preferred Stock, Excerpts from	16009	5875
Page 1	16009	5875
Pages 3 to 8, Application of Proceeds, etc.	16011	5877
Pages 11 to 13, Certain Proposed Acquisitions, etc.	16019	5889
Page 16, Letter to Board of Directors, November 13, 1941 ..	16024	5895
Page 66, Notes to Balance Sheets	16075	5897
Page 69, Notes to Income Account	16078	5898
234, Summary of Construction and Retirement Budget and Work Order Procedure	16095	5901
235, Panhandle Eastern Pipe Line Company and Subsidiary Companies Statement showing the Computation of Depreciation for Federal Income Tax Purposes for the year 1939 as claimed in Federal Income Returns	16097	5903
236, Panhandle Eastern Pipe Line Company and Subsidiary Companies Statement showing the Computation of Depreciation for Federal Income Tax Purposes for the year 1939 on the basis as settled with the Bureau of Internal Revenue	16098	5905
237, Panhandle Eastern Pipe Line Company and Subsidiary Companies Statement showing the Computation of Depreciation for Federal Income Tax Purposes for the year 1940 as claimed in Federal Income Tax Return	16099	5907
238, Panhandle Eastern Pipe Line Company and Subsidiary Companies Statement showing the Computation of Depreciation for Federal Income Tax purposes for the year 1940 on the basis as settled with the Bureau of Internal Revenue	16100	5909

243, Panhandle Eastern Pipe Line Company and Subsidiary Companies Statement of Estimated Federal Income and Excess Profits Taxes for the 12 months ended February 28, 1942 (based on Revenue Act of 1941)	16105	5911
244, Panhandle Eastern Pipe Line Company and Subsidiary Companies Statement of Budget Items included in Exhibit No. 205	16108	5917
245, Agreement between Columbia Gas & Electric Corporation and Panhandle Eastern Pipe Line Company dated February 5, 1942	16110	5921
246, Panhandle Eastern Pipe Line Company and Subsidiary Companies preliminary Determination of the second Installment of Purchase Price to be paid to Columbia Gas & Electric Corporation, computed in accordance with Provisions (Paragraph C) of the Agreement between Columbia Gas and Electric Corporation and Panhandle Eastern Pipe Line Company dated February 5, 1942	16123	5932
247, Panhandle Eastern Pipe Line Company and Subsidiary Companies Statement showing Certain Increased Costs not fully Present in Income Account (Exhibit 195 and 196) for the year 1941	16124	5933
248, Panhandle Eastern Pipe Line Company and Subsidiary Companies pro forma Consolidated Income Account for the year ended December 31, 1941	16125	5935
249, Panhandle Eastern Pipe Line Company and Subsidiary Companies pro forma Consolidated Income Account for the year ended December 31, 1941 (Note A), as adjusted to give effect to Federal Income and Federal Excess Profits Tax Rates proposed in Recommendation of Secretary of Treasury Morgenthau on March 3, 1942 before House Ways and Means Committee	16128	5939
250, Panhandle Eastern Pipe Line Company and Subsidiary Companies Statement of Rate Case Expenses in Connection with Federal Power Commission Consolidated Dockets G-200 and G-207 including actual cost to February 28, 1942 and Estimated Cost to complete	16131	5942
250-A, Panhandle Eastern Pipe Line Company and Subsidiary Companies Statement of Rate Case Expenses in Connection with Federal Power Commission Consolidated Dockets G-200 and G-207 including actual Cost to February 28, 1942 and Estimated Cost to complete	16131A	5943
251, Panhandle Eastern Pipe Line Company and Subsidiary Companies Statement showing pro forma Consolidated Net Operating Revenue as adjusted for a full Year's Cost (Note A) as allocated between regulated and non-regulated Sales for the year ended December 31, 1941	16132	5947
252, Panhandle Eastern Pipe Line Company and Subsidiary Companies Additional Information requested in re Exhibit No. 17	16138	5956
253, Study relative to Minimum Return Requirements of Panhandle Eastern Pipe Line Company (giving Effect to Property Acquisitions) prepared by Paul B. Coffman Chart No. 1, Condensed/Actual and pro forma Balance Sheets of Panhandle Eastern Pipe Line Company as of December 31, 1941	16145	5961
	16149	5967

Index Volume XIV.

Original Print

Chart No. 2, Trend of Revenue and Expenses of Panhandle Eastern Pipe Line Company from 1932 to 1941 and pro forma	16150	5969
Chart No. 3, Percent Earned on Invested Capital of Panhandle based upon Net Gas Plant and Working Capital from 1932 to 1941	16151	5971
Chart No. 4, Percent Earned on Invested Capital of Panhandle based upon Capital Structure from 1932 to 1941	16152	5973
Chart No. 5, Return to Common Stockholders of Panhandle Eastern Pipe Line Company from 1932 to 1941	16153	5975
Chart No. 6, Percent Earned on Invested Capital of Panhandle pro forma for 12 Months ended February 28, 1942	16154	5977
Chart No. 7, Percent Earned on Invested Capital of Panhandle pro forma for 12 Months ended February 28, 1942	16155	5979
Chart No. 8, Working Capital of Panhandle Eastern Pipe Line Company is being Reinvested in Fixed Assets	16156	5981
Chart No. 9, Effect of Sinking Fund and Maturity Provisions of Debt and Preferred Stock of Panhandle Eastern Pipe Line Company	16157	5983
Chart No. 10, Investors' Appraisal of Overall Capital Risks in Various Divisions of the Utility Industry from 1937 to 1941	16158	5985
Chart No. 11, Investors' Appraisal of Overall Capital Risks 153 Stable Industrial Companies	16159	5987
Chart No. 12, Panhandle Eastern Pipe Line Company invested Capital as of February 28, 1942	16160	5989
Chart No. 13, Cost of Financing Panhandle Eastern Pipe Line Company First Lien and First Mortgage Series "C" S. F. 3's due January 1, 1962	16161	5991
Chart No. 14, Historical Costs of Debt Capital of Panhandle Eastern Pipe Line Company from 1930 to 1942	16162	5993
Chart No. 15, Cost of Financing Panhandle Eastern Pipe Line Company 5.60% Preferred Stock	16163	5995
Chart No. 16, Historical Costs of Preferred Stock Capital of Panhandle Eastern Pipe Line Company from 1936 to 1942	16164	5997
Chart No. 17, Record of Sales of Panhandle Eastern Pipe Line Company 5.60% Preferred Stock to Public from February 4 to March 30, 1942	16165	5999
Chart No. 18, Price to Public of Panhandle Eastern Pipe Line Company 5.60% Preferred Stock reduced on April 2, 1942	16166	6001
Chart No. 19, Record of Sales of Panhandle Eastern Pipe Line Company 5.60% Preferred Stock to Public from April 2 to April 10, 1942	16167	6003
Chart No. 20, Assumed Cost of Financing Panhandle Eastern Pipe Line Company 5.60% Preferred Stock	16168	6005
Chart No. 21, Earnings — Price Ratios of Natural Gas Pipe Line Company Common Stocks from 1937 to 1941	16169	6007
Chart No. 22, Average Earnings — Price Ratios of Natural Gas Pipe Line Company Common Stocks from 1937 to 1941	16170	6009

Chart No. 23, Accepted Earnings — Price Ratio for Panhandle Eastern Pipe Line Co. Common Stock	16171	6011
Chart No. 24, Minimum Earnings required for Common Stock of Panhandle Eastern Pipe Line Company	16172	6013
Chart No. 25, Minimum Earnings required to Maintain Credit Position of Panhandle Eastern Pipe Line Company	16173	6015
Chart No. 26, Minimum Earnings required to Maintain Credit Position of Panhandle Eastern Pipe Line Company	16174	6017
Chart No. 27, Prime Money Rates Monthly from 1930 to March, 1942	16175	6019
Chart No. 28, Commercial Loan Rates Charged Customers by Banks in Principal Cities — Monthly, from 1930 to 1942	16176	6021
Chart No. 29, Yields on U. S. Government and High Grade Municipal Bonds Monthly, from 1930 to March, 1942	16177	6023
Chart No. 30, Standard's Highest Grade (A1+), Corporate Bond Yields Monthly, from 1930 to March, 1942	16178	6025
Chart No. 31, Standard's Corporate Bond Yields — by Quality Rating Monthly, from 1937 to March, 1942	16179	6027
Chart No. 32, Standard's Public Utility Bond Yields — by Quality Rating Monthly, from 1937 to March, 1942	16180	6029
Chart No. 33, Bonds, Debentures and Notes issued by Natural Gas Companies from 1936 to 1941	16181	6031
Chart No. 34, Bonds and Debentures of Natural Gas Companies sold from January 1, 1936 to December 31, 1941	16182	6033
Chart No. 35, Yields on New Security Issues of Natural Gas Companies according to Quality Rating, from 1936 to 1941	16183	6035
Chart No. 36, Ideal Earnings Coverage Ratios for High Grade (A Group) Natural Gas Company Bonds	16184	6037
Chart No. 37, Debt Coverage Ratios for El Paso Natural Gas Company Actual and Adjusted to a 6-1/2% Rate of Return	16185	6039
Chart No. 38, Debt Coverage Ratios for Northern Natural Gas Company Actual and Adjusted to a 6-1/2% Rate of Return	16186	6041
Chart No. 39, Debt Coverage Ratios for Southern Natural Gas Company Actual and Adjusted to a 6-1/2% Rate of Return	16187	6043
Chart No. 40, Debt Coverage Ratios for Cities Service Gas Company Actual and Adjusted to a 6-1/2% Rate of Return	16188	6045
Chart No. 41, Debt Coverage Ratios for Mississippi River Fuel Corporation Actual and Adjusted to a 6-1/2% Rate of Return	16189	6047
Chart No. 42, Debt Coverage Ratios for Natural Gas Companies Adjusted to 6-1/2% Return on Net Property and Working Capital	16190	6049

Chart No. 43, Debt Coverage Ratios of Panhandle Eastern Pipe Line Company at Various Levels of Net Operating Revenue.....	16191	6051
Chart No. 44, Debt Coverage Ratios of Panhandle Eastern Pipe Line Company at Various Levels of Net Operating Revenue.....	16192	6053
Chart No. 45, Effect of Increased Gross Revenue and Taxes upon Panhandle's Net Operating Revenue.....	16193	6055
Chart No. 46, Calculation to show Rate of Return Necessary to Produce \$5,382,677; — Assuming Various Rate Bases.....	16194	6057
Tables supporting Various Charts.....	16196	6061
254, Investors' Appraisal of the Risks of Capital in 153 Stable Industrial Companies for the years 1937 to 1941, inclusive, prepared by Paul B. Coffman.....	16242	6153
Section I, Complete List of Industrial Companies whose Common Stocks were Listed on the New York Stock Exchange from January 1, 1932 to April 1, 1942, etc.....	16246	6161
Section II, Summary showing Computation of "Investors' Appraisal of the Risks of Capital represented by 153 Stable Industrial Companies".....	16250	6169
Section III, Working Papers showing the Computation of "Investors' Appraisal of the Risks of Capital" of each of the 153 Stable Industrial Companies.....	16254	6177

Index, Volume XV. and XVI.

Section IV, Working Papers showing the Computation of "Investors' Appraisal of the Risks of Capital" in the Natural Gas Industry as compared with other Divisions of the Utility Industry for the full Year 1941, etc.....	16530	6729
255, Letter of Panhandle Eastern Pipe Line Company dated April 11, 1942 to Mr. Park Chamberlain, and Tabulation of Comparative Statement of Demand Charges under Original and Supplemental Contracts, Panhandle Eastern Pipe Line Company and Michigan Consolidated Gas Company for Detroit.....	16582	6833
256, Letter Agreement between Columbia Oil & Gasoline Corporation, National City Company and Missouri-Kansas Pipe Line Company, dated September 19, 1930 and Contract dated September 17, 1930.....	16585	6839
257, Panhandle Eastern Pipe Line Company and Subsidiary Companies Reconciliation of Net Income per books with Estimated Excess Profits Net Income for the year 1941.....	16595	6853
258, Holding Company Act Release No. 3415 dated April 1, 1942; Findings and Opinion of the Securities and Exchange Commission in the Matter of Columbia Gas & Electric Corporation, File Nos. 59-33, etc.....	16599	6856
Order requiring Divestiture pursuant to Section 11 (b) (1) and Redistribution of Voting Power pursuant to Section 11 (b) (2).....	16606	6865
259, Weighted Average Earnings — Price Ratios on Common Stocks 153 Stable Industrial Companies.....	16608	6867

	Original Print	
260, Panhandle Eastern Pipe Line Company Status of Proposed 1942 Construction Program, Production and Gathering System South and West of Liberal Station	16609	6868
261, Panhandle Eastern Pipe Line Company and Subsidiary Companies Main Line System Approximate Coincidental Maximum Day Sales during the Winter Periods of 1940-1941 and 1941-1942	16612	6871
262, Panhandle Eastern Pipe Line Company and its Subsidiary Companies Interruptible Customers Curtailment — January 4-12, 1942	16617	6881
263, Panhandle Eastern Pipe Line Company and Subsidiaries Allocation of Adjusted 1941 Costs between Regulated and Non-regulated Sales	16618	6883
264, Index of Gas Rate Schedule of Illinois Natural Gas Company, Michigan Gas Transmission Corporation and Panhandle Eastern Pipe Line Company	16621	6889
Schedule 12, Gas Contract between Panhandle Eastern Pipe Line Company and Detroit City Gas Company, August 31, 1935	1	6889
Supplement 2 of Schedule 12, Supplemental Gas Contract between Panhandle Eastern Pipe Line Company and Detroit City Gas Company, June 2, 1936	1	6920
266, Financial Statement of Indiana Gas Distribution Corporation for Period ended December 31, 1941	16643	6929
267, Panhandle Eastern Pipe Line Company and Subsidiary Companies Comparative Balance Sheets — per books, Comparative Earnings Summary — per books, Adjusted Earnings Summary and Gas Plant — per books as of March 1, 1941, and March 31, 1942	16676	6993
Complaint of City of Detroit and County of Wayne, Complainants v. Panhandle Eastern Pipe Line Company and Michigan Gas Transmission Corporation, Defendants, filed February 28, 1941, Federal Power Commission, Docket No. G-200	16686	7002
Separate Answer of Michigan Gas Transmission Corporation filed March 28, 1941 in Docket No. G-200	16693	7008
Petition of Michigan Public Service Commission for Leave to intervene filed March 31, 1941 in Federal Power Commission, Docket No. G-200	16698	7011
Separate Answer of Panhandle Eastern Pipe Line Company filed April 3, 1941 in Federal Power Commission, Docket No. G-200	16705	7015
Order entered June 10, 1941 fixing date of Hearing in Federal Power Commission, Docket No. G-200	16715	7022
Order entered June 10, 1941 permitting the Michigan Public Service Commission to intervene in Federal Power Commission, Docket No. G-200	16718	7024
Petition of Panhandle Eastern Pipe Line Company filed June 26, 1941 for Continuance of Hearing in Docket No. G-200	16726	7025
Concurring Petition of Michigan Gas Transmission Corporation filed July 3, 1941 for Continuance of Hearing in Docket No. G-200	16728	7030

XXT

Original Print

Objection of City of Detroit and County of Wayne to Defendant's Petition for Continuance of Hearing filed July 3, 1941 in Docket No. G-200	16733	7032
Federal Power Commission's Designation of Trial Examiner	16736	7034
Order entered July 8, 1941 denying Petitions for Continuance of Hearing in Docket No. G-200	16	7034
Petition of Michigan Consolidated Gas Company for Leave to intervene filed July 19, 1941 in Docket No. G-200	16739	7035
Petition of Intervention	16744	7038
Order entered July 12, 1941 permitting Michigan Consolidated Gas Company to intervene in Docket No. G-200	16755	7046
Answer of Michigan Gas Transmission Corporation to Petition of Intervenor, Michigan Consolidated Gas Company	16757	7047
Answer of Panhandle Eastern Pipe Line Company to Petition of Michigan Consolidated Gas Company, Intervenor, filed August 18, 1941 in Docket No. G-200	16762	7051
Motion to Dismiss filed by Panhandle Eastern Pipe Line Company on August 20, 1941 in Docket No. G-200	16771	7058
Motion to Dismiss filed by Michigan Gas Transmission Corporation on August 21, 1941 in Docket No. G-200	16773	7059
Order of Federal Power Commission denying Motions to Dismiss of Panhandle Eastern Pipe Line Company and Michigan Gas Transmission Corporation	16775	7060
Order of Federal Power Commission entered May 22, 1941 instituting Investigation in Docket No. G-207	16786	7061
Order of Federal Power Commission entered September 2, 1941 consolidating Proceedings for Purposes of Hearing, Dockets Nos. G-200 and G-207	16779	7054
Petition of Panhandle Eastern Pipe Line Company filed February 4, 1942 for Continuance of Hearing	16799	7065
Objection of City of Detroit and County of Wayne filed February 11, 1942 to petition for Continuance of Hearing	16809	7070
Order of Federal Power Commission entered February 17, 1942 denying Petition for Continuance and Changing Place of Hearing in Dockets Nos. G-200 and G-207	16811	7072
Petition for Continuance of Hearing filed by Panhandle Eastern Pipe Line Company and Michigan Gas Transmission Corporation on February 28, 1942	16814	7073
Exhibit A, Limitation Order L-31 to certain Consumption of Natural Gas	16823	7079
Exhibit A, Areas subject to Prohibitions contained in Paragraph (e) of Limitation Order L-31	16828	7084
Order of Federal Power Commission entered March 26, 1942 enlarging Investigation and making Illinois Natural Gas Company a Party Respondent in Proceeding Designated Docket No. G-207	16834	7088
Motion of Counsel for Federal Power Commission filed April 27, 1942 praying that the Federal Power Commission enter an immediate Order fixing just and reasonable Rates	16839	7091
Motion filed by Michigan Consolidated Gas Company on April 27, 1942 praying that the Federal Power Commission enter an immediate Order reducing Rates	16849	7098

Motion filed by City of Detroit and County of Wayne on April 27, 1942 praying that the Federal Power Commission enter an immediate Order reducing Rates	16853	7100
Amendment to Motion for Order reducing Rates filed by Michigan Consolidated Gas Company on April 28, 1942	16860	7104
Statement relating to Excess Return for year 1941 and Reduction of Gross Revenues required to eliminate Excess Return	16865	7107
Excess Return for year 1941, before Adjustment of Claim for Replacements	16866	7107
Rate Base for year 1941	16867	7109
Income Statement — year 1941	16868	7111
Amortization of Investment	16871	7114
Annual Accrual Rate for Amortization of Property as of June 30, 1941	16872	7115
Annual Accrual for Amortization of Property at June 30, 1941	16873	7116
Depletion	16874	7116
Excess Return for year 1941	16875	7117
Rate Base for year 1941	16876	7118
Income Statement — year 1941	16877	7119
Adjustments to 1941 Income Statement for Changes in Operating Expenses not fully effective for Entire Calendar year 1941	16878	7121
Stipulation of Counsel for the various Parties and Federal Power Commission Counsel consenting to withdrawal of Federal Power Commission Counsel's Motion for Immediate Order reducing Rates filed May 11, 1942	16881	7123
Motion of Counsel for Federal Power Commission for Immediate Order reducing Rates filed on May 11, 1942	16882	7125
Opinion Number 80 of Federal Power Commission, Memorandum as to Order of Federal Power Commission reducing Rates, September 23, 1942, Memorandum as to	16892	7133
Petition of Panhandle Eastern Pipe Line Company, Michigan Gas Transmission Corporation and Illinois Natural Gas Company filed October 9, 1942 requesting an extension of time within which to file new Schedules of Rates and Charges	16934	7134
Order of Federal Power Commission of October 12, 1942 granting Extensions of Time to Panhandle Eastern Pipe Line Company, Michigan Gas Transmission Corporation and Illinois Natural Gas Company to file new Schedules of Rates and Charges	16938	7137
Petition of Panhandle Eastern Pipe Line Company, Michigan Gas Transmission Corporation and Illinois Natural Gas Company filed October 23, 1942 for stay of the Federal Power Commission's order of September 23, 1942	16940	7138
Petition of Panhandle Eastern Pipe Line Company, Michigan Gas Transmission Corporation and Illinois Natural Gas Company filed October 23, 1942 requesting a rehearing in Dockets Nos. G-200 and G-207	16944	7141
Order of Federal Power Commission of October 30, 1942 denying Petitions for Rehearing and for Stay in Dockets Nos. G-200 and G-207	16954	7150

	Original Print	
Certificate to Transcript of Federal Power Commission	16955	7151
Order of United States Circuit Court of Appeals directing Respondents to Show Cause why Petition for Stay of Rate Order should not be granted	16986	7179
Order of United States Circuit Court of Appeals denying Petition for Stay of Operation of Rate Order without prejudice, etc.	16987	7180
Order of United States Circuit Court of Appeals granting Stay pending further hearing of application therefor	16988	7181
Order of United States Circuit Court of Appeals granting Stay of Order of Federal Power Commission dated September 23, 1942, requiring reduction in rates and charges for gas furnished by Petitioners, etc.	16989	7182
Order of United States Circuit Court of Appeals appointing John G. Hughes as Custodian of Funds to be impounded under provisions of Stay Order	16991	7184
Order of United States Circuit Court of Appeals as to form of record to be printed and fixing time for filing designations therefor	16992	7185
Order of United States Circuit Court of Appeals instructing Custodian as to manner of handling funds and securities in his possession	16993	7186
Order of United States Circuit Court of Appeals authorizing Custodian to purchase certain securities as investments	16995	7187
Order of United States Circuit Court of Appeals directing Petitioners to pay to Custodian certain sums to cover Bond premium, etc.	16997	7188
Order of United States Circuit Court of Appeals requiring Custodian to set up Account No. 1 and Account No. 2, etc.	16999	7189
Order of United States Circuit Court of Appeals authorizing Custodian to purchase certain securities, etc.	17001	7190
Stipulation that coloring matter appearing on certain Exhibits may be omitted from copies inserted in printed record, etc.	17003	7191
Appearances of Counsel for Petitioners	7193	7193
Appearances of Counsel for Respondents	7195	7194
Order of Submission	7196	7196
Order for Resubmission of Case	7200	7196
Order resetting case for argument	7201	7197
Order of Resubmission	7202	7197
Opinion, U. S. Circuit Court of Appeals	7203	7198
Judgment, U. S. Circuit Court of Appeals	7226	7219
Clerk's Certificate to Transcript	7228	7220
Order allowing certiorari	7230	7221

Q. Whether it is retained by him and paid out at the end of the life of the company in a liquidating dividend is immaterial for purposes of this discussion and this study.

A. Well, I—

Q. (Interposing) That does not disturb me at all. [fol. 7046] The thing I want to make certain about is that the amortization of this premium of \$11.40 must come out of the 10.38 percent figure shown in your Chart No. 21 for Northern Natural Gas Company's common stock. Is that right?

A. That is right, it must come out, but I still want to get clear on the record that unless they pay a dividend there is no use at all of any common-stockholder working out any amortization schedule, because he is just sitting there as a stockholder holding the bag and that is important to this study, notwithstanding the statement that you said it was not.

Q. You say the stockholder is not at all aware of the fact that he is paying \$11.40 in excess of the par value of the stock?

A. I did not say that.

Mr. Calton: Did you say par value or book value?

Mr. Littman: Either one, I will say par value.

The Witness: Par value, I will say, of course, the stockholder knows that. If he buys a share it is stated on the face.

By Mr. Littman:

Q. Now, your earnings-price ratio of 10.38 percent was not adjusted by you to take into account this situation which we have been discussing of the amortization of the premium. Is that right?

[fol. 7047] A. Not at all, because it cannot be. How can it be?

(Discussion off the record.)

[fol. 7050] LEITH V. WATKINS, a witness, having been previously duly sworn, resumed the stand and testified further as follows:

[fol. 7051] By Mr. Gorman:

Q. Mr. Watkins, will you please refer to the copy of Exhibit No. 39 for identification which I have handed to you and refer to Page 966 of that proposed exhibit, which is entitled, "Panhandle Eastern Pipe Line Company and Subsidiary Companies—Cost of Business Development" and will you notes at Lines 1 to 29 thereon are set forth certain statements purporting to represent payments to utility companies which, according to Line 30, represent a total of such payments of \$553,992.48.

Can you tell us what disposition of these various amounts was made on the books of the Panhandle Eastern Pipe Line Company, that is to say, were these items charged to expense or were they capitalized?

A. Before answering, may I properly identify what [fol. 7052] has been submitted to me as Exhibit No. 39. It is not so marked as you gave it. I am of the opinion that it is what I know to be Exhibit No. 39 and I believe your question spoke of the title of the exhibit generally being "Cost of business development" whereas it appears that the correct title of the entire exhibit is "Reproduction Cost New of Property Plant and Business as of June 30, 1941."

Q. Yes, but the title I read is shown on Page 966.

Mr. Wheat: Your question, Mr. Gorman, was whether these items—what was that page?

Mr. Gorman: Page 966.

Mr. Wheat: Were capitalized or charged to operations?

Mr. Gorman: That is right.

The Witness: The witness' memory at the moment with respect to virtually all of the items shown on Page No. 966 of Exhibit No. 39 is that the charges they represent were first registered against gas sales and purchase contracts and have been held in that account subject to gradual amortization.

Now, it may very well be that some of the smaller items, such as that shown on Line 3, amounting to \$152.50 or that shown on Line 4 amounting to \$651 or other items of that general nature may not have first gone into the account Gas Sales and Purchase Contracts.

As a matter of fact, they may never have been registered as a charge against that account.

Does that supply the information you seek, sir?

By Mr. Gorman:

Q. Partially so.

A. We may as well identify these two sheets, don't you think?

Q. It may be well, yes. You are referring to certain working papers?

A. To two working papers which counsel just presented to the witness?

Q. Yes.

A. They are copies of Pages 13 and 14 to this witness' working papers with respect to Exhibit No. 52.

Q. Do those working papers, Mr. Watkins, show that of this total amount of \$553,992.48 only \$33,130, representing the amount shown at Lines 3 to 11, inclusive, on Page 966 of this Exhibit No. 39, have been charged to operating expenses on the books of the Panhandle Eastern Pipe Line Company?

A. These working papers do not make such showing, that is, Pages 13 and 14 of the working papers to Exhibit No. 52.

Q. Do you have any other working papers or any other information which would permit you to answer the question I have propounded?

[fol. 7054] A. My attention has been called to a memorandum which apparently was supplied during the course of the examination of certain of the company's records by some member of the staff of the Commission during one of their visits to our office at Kansas City, which seem to indicate that some of the \$553,992.48 shown on Line 30 of Page No. 966 of Exhibit No. 39 had been charged to operating expenses and that \$520,862.48 of the same total amount had been charged to other gas sales and purchase contracts, but notwithstanding the treatment which may

have been given to these items on the company's books, they do represent payments made to utility companies as shown on Line 1 of Page 966 of Exhibit No. 39.

Q. Yes, but the amount of \$520,862.48, which you have just supplied, has been capitalized and charged to the account of gas plant, gas sales and purchase contracts, has it not?

Mr. Wheat: I wonder if you would give me that figure? I want to get it.

Mr. Gorman: \$520,862.48, which account is presently being annually provided for looking to a subsequent and complete amortization, is it not?

The Witness: That is true and, Mr. Gorman, there is no contention on the part of the company, as far as I know, that some portion of the total \$553,992.48 shown on Line 30 [fol. 7055] as total payments to utility companies has not been charged to operating expenses through amortization since the creation of those charges on the company's books.

There has been testimony, I believe, on questions asked heretofore in these proceedings with respect to that amount, \$553,992.48, and an amount of \$365,334.99 shown on Page 16 of the working papers to Exhibit No. 52 which represented the balance at June 30, 1940, of a portion of the item shown on Page 966 of Exhibit No. 39 comprising the total \$553,992.48.

By Mr. Gorman:

Q. I might state that the questioning with respect to the items shown on this page, according to my present recollection, was directed to Mr. Biddison who offered this Exhibit No. 39.

As I recall Mr. Biddison's testimony, he was not familiar with the charges on the books of the company with respect to the items which make up the total shown at Line 30 on this page.

It is also Mr. Biddison's testimony that he merely took these figures, as furnished to him by the Accounting Department of the Panhandle Eastern Company and, in further explanation, I should like to state I am merely inquiring of you and trying to determine for this record pre-

cisely what portion had been previously written off by the [fol. 7056] company as a charge to operating expenses and what portion was capitalized in the gas plant account of the company and charged to the account for gas sales and purchase contracts.

Now, as I understand, your testimony presently is and in accordance with the best information available to you at the moment, that \$33,130 of the total of \$553,992.48 was written off as a direct charge to operating expense and that the balance of \$520,862.48 was capitalized in the gas plant account, is that correct?

A. Well, without raising any particular objection to your characterization "written off" and "capitalized", I think that is substantially a correct statement.

Q. Yes.

A. We are speaking about the original treatment of these items, that is, at the time they first came into existence, not with respect to what has happened to them since they were first so disposed of.

Q. By that, are you referring to the fact that there has been certain amortization applied to the amount which was capitalized?

A. To illustrate what I mean, if you will refer to Page No. 15 of Exhibit No. 52—

Mr. Wheat: (Interposing) You mean of these working papers that counsel has now presented to you for consideration?

The Witness: That is correct—you will observe there [fol. 7057] that the total amount of payments made, on account of contracts with Michigan Consolidated Gas Corporation, agents assisting in the procurement of such contracts, with respect to the change-over cost by Michigan Consolidated Gas Company and contributions in connection with the acquirement by that company of house heating customers, was \$438,000, a portion of which was applicable to Michigan Gas Transmission Corporation.

The residue was applicable to the affairs of Panhandle Eastern Pipe Line Company and constitutes the \$371,076 shown opposite Line 13.

Mr. Wheat: You mean Line 13 on Page 966 of Exhibit 39?

The Witness: Correct.

Mr. Wheat: Thank you.

The Witness: Now, at June 30, 1941, there had been \$113,214.74 of the \$371,076 applicable to Panhandle Eastern amortized through gradual charges to operating expenses so that the portion of the balance in the gas sales and purchase contracts to which the original amount \$371,076 had been charged, amounted on June 30, 1941, to \$257,861.26.

That is intended to illustrate what has happened to the original charges, either to gas sales and purchase contracts or to operating expenses subsequent to the making of such original charges.

By Mr. Gorman:

[fol. 7058] Q. Yes.

A. Now, if I may proceed slightly further, the items shown on Page 966 of Exhibit No. 39 on lines 1 to 11 and possibly some of the smaller items elsewhere on that page constitute the \$33,130 previously referred to here this morning and are not a part of Pages 15 and 16 of the working papers to Exhibit No. 52. But those working papers very clearly show a total amount of original charges of \$627,905.55, a portion of which was applicable to the affairs of Michigan Gas Transmission and show that, of that amount, Panhandle Eastern Pipe Line Company had amortized at June 30, 1941, \$155,527.49 so that at June 30, 1940—

Mr. Wheat: (Interposing) 1941?

The Witness: That is correct. The working papers, however, have a column headed "June 30, 1940", which is apparently in error. The balance was \$365,334.99 of the original \$520,862.48.

There is no secret that there has been amortization of those amounts since they were first charged to gas sales and purchase contracts.

By Mr. Gorman:

Q. Yes. Is there presently any proposal on the part of the company or on your own part to change in any way the charges which have been made to these various items [fol. 7059] on the books of the company?

A. Not unless and until there be some circumstance, such as the cessation of deliveries under any of the contracts, for whatever reason, to bring such condition about or unless the company, at some time in the future were to adopt a policy of disposing of the entire balance.

Further than those possibilities, it would seem that our plan of amortization would continue.

Q. You spoke of the possible change in the event that deliveries were ceased under any one of these particular contracts to which any of these various charges are applicable.

What would be done in that event with such amounts?

A. I do not know that I am in position to definitely state. I think we would have to learn something of the conditions that existed at that particular time.

Now, I do remember that with respect to one of the charges made to gas sales and purchase contracts, possibly that shown on Page 16 of the working papers to Exhibit No. 52 which is there characterized as "Partial Refund of Contribution for Line Extension to Serve Industrial Customers (Ingram-Richardson)" that by Voucher No. 10.54 entered in the year 1940, a credit of some \$2,500 was made to this account.

The reason for that, if the witness' memory is accurate, [fol. 7060] is due to the fact that the arrangement with the customer in this instance was such that if the total amount of gas purchased over the period covered by the purchase contract under which such sales were being made was not sufficient at some stipulated rate in the contract to equal the amount of the original advance made jointly to that company by Panhandle Eastern, Michigan Gas Transmission and possibly one of the Indiana companies, that the unamortized portion would be refunded and the amount the witness has referred to represents the portion of such residue applicable to the affairs of Panhandle Eastern.

Such things as that could give rise to changes here.

Q. Of course, just exactly what disposition might conceivably be made in the future of these various items is not presently known to you?

A. So far as the records are concerned, that is quite correct.

Now, if I may make this further remark: The request that came to the company with respect to certain items shown on Page 966 of Exhibit No. 39, I am now very much of the opinion, was improperly interpreted by those of us who prepared the information or had it prepared.

Were such a request to be made of this witness today, in the manner in which it was originally made—

Q. (Interposing) By whom was such request made?
[fol. 7061] A. (Continuing) —the total would have been on the order of \$2,400,000.

Would you like an explanation of how that might be arrived at?

Mr. Culton: He injected a question there.

By Mr. Gorman:

Q: I was just going to repeat that. I was going to ask, when you referred to a request of your or other accounting officials of the company, by whom was such request made?

A. The record in the proceedings, Mr. Gorman, very clearly shows that Mr. Biddison testified that the information shown on Lines 1 to 30 on Page 966 of Exhibit 39 was supplied to him by officers of the company.

It happens that your present witness is the officer who supplied it. The request for the information came from Mr. Biddison and the request, if I recall it, ran something along this order: "Will you please prepare and furnish me a statement showing payments to utility companies?"

Now, I am probably at fault by not having examined that request a little bit more than my memory at this moment tells me I did examine it. There was and still is on the books of the company two amounts having to do with gas sales and purchase contracts; one of which, at June 30, 1941, as shown by Line 40 on Page 2 of Exhibit No. 52 was \$2,930,286.40.

The other amount, as shown by Lines 43 and 44 of the [fol. 7062] same page of the same exhibit was \$365,334.99.

Now, when the question was put to your witness with respect to this amount, properly or improperly the witness connected it with the original items which gave rise to the balance of \$365,334.99 shown opposite the caption on Lines 43 and 44 on Page 2 of Exhibit No. 52.

It did not dawn on me then and I did not awaken to the fact that perhaps what Mr. Biddison was requesting was the total amount of such payments from the very inception of the company until I had occasion to take a quick glance at a portion of his testimony.

So, as I stated before, had the question been put subsequent to such knowledge on my part or had my thoughts at the moment been a little bit more mature than I now see they were, the total we would have given to Mr. Biddison would have been on the order of \$2,408,000 and I should be very glad to supply you what seems to me to be the items that constitute that total, if you wish them.

Mr. Gorman: Will you read that answer back, Miss Reporter, please?

(Whereupon, the last answer was read by the reporter.)

By Mr. Gorman:

Q. Will you please refer us to those items which constitute the total of \$2,400,000?

A. Refer you to them where?

[fol. 7063.] Q. Well, you said you would furnish that information. I was wondering if it was shown on any of these exhibits.

A. It is not, as such, but the detail of the items is a part and parcel of the company's records. Not all of the things that have been shown here or will be shown here are a minute part of the exhibits which have been or may be presented in the proceedings, I do not believe.

Q. Are such amounts that constitute the total of \$2,400,000 shown in the balance sheets, Exhibit No. 48, or in the income statement, Exhibit No. 49, or in the gas plant account, Exhibit No. 52?

A. Yes; sir, they are.

Q. Very well. Will you please proceed to give us an explanation of those items which you are referring to?

A. The total, \$2,408,623.50 is comprised of the following items:

In connection with contracts acquired by assignment from Missouri-Kansas Pipe Line Company as of September 1, 1930 (amount at which carried on the books of Missouri-Kansas Pipe Line Company)— \$1,106,250.

Notes issued for purchase of Missouri-Kansas Pipe Line Company stock used in connection with obtaining gas sales contracts— \$556,000.

Amount paid Missouri-Kansas Pipe Line Company to [fol. 7064] reimburse them for expenses incurred in obtaining gas sales and purchase contracts— \$75,000.

Premium paid for contract bond in connection with obtaining gas sales contracts— \$1,000.

Payment to agents for fees and expenses in connection with obtaining gas sales contracts— \$9,500.

Traveling expenses of F. P. Parish in connection with obtaining gas sales contracts— \$786.30.

Payroll and expense incurred in connection with obtaining gas sales contracts— \$12,703.04.

Those items make a total of \$1,761,239.34 and comprise a part of the \$2,930,286.40 shown opposite Line 40 on Page 2 of Exhibit No. 52.

Then there were other gas sales and purchase contracts consisting of the following:

Costs of securing gas sales contracts, contributions to change-over costs, new house heating customers' campaign and line extension costs, and so forth, in connection with gas sales contracts, acquired since August 31, 1935, segregated as:

Costs to June 30, 1941— \$520,862.48 and

Costs July 1 to November 30, 1941— \$6,724.

Making a total of— \$527,586.48.

Then there were further costs of attaching business, originally charged to fixed capital account then in use as [fol. 7065] No. 203, separated between:

Market survey— \$28,932.74

Other costs— \$57,734.94

Those two items aggregate— \$86,667.68.

Then there were costs charged to operating expenses as previously testified represented by disbursements for cost of business development in Missouri and Illinois and house heating customers' campaign amounting to—
 * \$33,130.

The total of all of which is— \$2,408,623.50.

Q. Does that complete your answer?

A. Yes, sir, it does.

Q. And according to your previous statements, had you known at the time you prepared the information at Mr. Biddison's request instead of furnishing the amounts totaling \$553,992.48 as shown at Page 966 of Exhibit No. 39, you would have furnished the items which you have just read into the record totaling \$2,408,623.50, is that correct? A. Yes, that is correct.

Now, the reason for the apparent misunderstanding, Mr. Gorman, is that no explanation was given, as I remember, as to the use and even had Mr. Biddison stated the use he intended to make of the material or if he had made such an explanation, the witness would probably have attached no great significance to it.

The record has clearly shown the two amounts we have [fol. 7066] referred to this morning on Lines 40, 43 and 44 on Page 2 of Exhibit No. 52. They were there for any one to treat with as they saw proper.

You can appreciate that company officials would not question Mr. Biddison necessarily as to the exact purpose he expected to use material he was requesting, no more than it would to seek to have the representatives of this Commission who were in our office at about the same time tell us what they proposed to do with the information they requested and we refurnished.

Q. Does that complete your answer? A. It does.

Q. Mr. Watkins, your previous references to Mr. Biddison's request indicate that such request was communicated to you in writing, is that correct?

A. No, sir, I do not believe I intended to leave any such inference. Mr. Biddison did make some requests to us

in writing. I do not recall at this moment just exactly what they were.

Mr. Biddison was in our office a very great portion of the time during the preparation of some of the material that he has introduced in these proceedings. Even your own staff, sir, did not present their requests in writing. I doubt very seriously if time would have permitted them to have reduced to writing all of the requests they made or [fol. 7067] [or] may hereafter make.

Q. That is entirely foreign to the question here.

A. The same thing applies to Mr. Biddison.

Q. Did Mr. Biddison furnish a written request for this information?

A. I do not recall.

Q. Will you undertake to determine from your records whether or not he did furnish such a request?

A. I shall.

Q. And if he did, will you furnish us with copies thereof together with any reply that you made thereto?

A. I think I can develop that information for you some time during the course of a rest period in the next day or so.

Q. Very well.

Now, when you refer to these items under the designation of "gas sales and purchase contracts", does that mean sales by the Panhandle Company to its customers and a purchase by the Panhandle Company of producers or others of a source or supply of gas?

A. Either Panhandle Eastern Pipe Line Company or its subsidiary companies.

Q. They are differentiated then, that is, there is a valuation of sales contracts on the one hand and of gas purchase contracts on the other hand?

[fol. 7068] A. No, they are commingled. There is no distinction between the amounts which occur on the books with respect to gas sales contracts or gas purchase contracts except in so far as some of the charges made to either of these accounts originally represented disbursements for a specific purpose.

I believe, Mr. Gorman, if you will permit the suggestion and without attempting to tell you what you should do, we

probably would get along a little faster and our record would be a little bit clearer if we treat with these items in two parts: If we think first of the \$2,930,000-odd item and then of the \$365,000-odd item, both of which are shown in Column M on Page 2 of Exhibit No. 52.

I only offer that suggestion, sir for whatever help it may be.

Q. Yes, I think we must necessarily do so.

A. And I believe, if you would permit me to kind of go along in my own fashion, I probably could help you a bit on the \$2,930,000-odd item. That is to say, if you want history in the record as to how it came into being and, generally, what it represented.

Q. I think we must get that, but first may I ask you a question or two, Mr. Watkins?

A. Certainly.

Q. Does this \$2,930,286.40 item to which reference has [fol. 7069] been made and which, as stated before, is shown at Line 40 of Page 2 of Exhibit No. 52, the particular mention being shown in Columns H to M, both inclusive, for the years 1936 through 1941, that is, through June 30, 1941.

That refers, does it not, to gas sales and purchase contracts acquired from the Missouri-Kansas Pipe Line Company at August 31, 1930?

A. Not necessarily so. My general explanation, if such an explanation is permitted to be made, would cover that point.

Q. Very well, maybe it would expedite things, Mr. Watkins, if you gave us what you consider to be your explanation of that item and, as you indicated before, confining it solely to the item we are now discussing.

A. When I first became connected with Panhandle Eastern Pipe Line Company and noticed an account on its books, "Gas Sales and Purchase Contracts", amounting at that time to something over \$3,000,000, I viewed the account with askance.

It seemed to me, from a very casual observation, that it might be the result of the effort on the part of someone to breathe life into something that did not exist, but, at

that time, I simply passed it out of my mind as being something that, when time permitted, I would find out what made it click and, believe you me, I have found out a good [fol. 7070] deal about it during the past ten years, and I turned my attention at that time to matters that seemed more important.

Now, as the years have passed, this is a summary of the things that have weeded themselves out of a great number of many other things with respect to this particular account.

First let's go back to a certain contract that has been mentioned heretofore in these proceedings of September 17, 1930, by virtue of which Panhandle Eastern Pipe Line Company came into possession of some \$19,000,000-odd of assets, the detail of which, I believe, is already in the record, and refer, as well, to Table No. 2 of the report by Mr. M. C. Steele of the Federal Trade Commission in response to Senate Resolution No. 83, the exact number of which I believe you, Mr. Gorman, supplied in the record one day last week.

Q. Yes, that is Volume 84-1 of the Federal Trade Commission Report.

A. And note on that table that there apparently was, on the books of Missouri-Kansas Pipe Line Company, an amount charged to gas contracts aggregating \$926,250, and that when such amount was recorded on the books of Panhandle Eastern Pipe Line Company, it became \$2,398,402.19.

The company's records with respect to the determination of the amount of \$2,398,402.19 show action on the part of [fol. 7071] the Board of Directors at a meeting held February 3, 1931, and without attempting to criticize in any manner the action by the Board of Directors at that particular time, it may have proven improvident and certainly troublesome that certain language was used in connection with that resolution because it had to do with statements concerning valuation.

The language might better have run to a statement that the action of the officers was assigning certain amounts to certain things recorded as a result of the contribution by

Missouri-Kansas Pipe Line Company was, in all respects, approved, ratified, and confirmed, but that was not done.

I find, in my search through the company's records and affairs and questioning of anyone that had anything to do with any of the transactions that gave rise to this amount, in so far as I was able to find any such individuals and I could not tell you at this moment who they were, that there apparently was a meeting of minds between a seller and a buyer in September, 1930, with respect to amounts at which one-half of the stock of Panhandle Eastern Pipe Line Company, purchased by Columbia Oil and Gasoline Corporation, were to be determined and it would appear that to an extent, at least, the entry giving rise to the \$2,398,402.19 of gas sales and purchase contracts took into consideration such a viewpoint or such an interpretation of the agreement between those two parties.

[Vol. 70724] Now, that might be characterized by some as a "write-up". Frankly and honestly, I do not know what a write-up is. I have searched the Authorities and I do not find any specific definition of a write-up, nor am I sure that such a statement can be made with respect to the recordation of an amount at which some asset is carried, presented by a donation, but be all that as it may, I have found this with respect to the \$2,398,402.19, that at the time an entry was made in 1930 by Journal Voucher J-2, 1930, there was apparently \$1,106,250 on the books of Missouri-Kansas Pipe Line Company representing disbursements made with respect to its affairs so that the remainder added to those disbursements by Panhandle Eastern Pipe Line Company in this original entry and by the Board of Directors at the action concerning which this witness has just referred ran to the order of \$1,292,152.19 rather than the amount of \$1,472,152.19 as shown by Mr. Steele's Table No. 2 as heretofore identified.

The difference between those two figures may have been the result of some adjustment made on the books of Missouri-Kansas Pipe Line Company subsequent to September, 1930, which is a fact that I have no knowledge whatever about and my statement with respect to that is pure conjecture.

Q. May I interrupt to get the statement with respect to those figures which you just read?

[fol. 7073] The Witness: During the year 1930, Panhandle Eastern added to the \$2,398,402.19 or rather had had some previous expenditures which raised the total of the charges to the gas sales and purchase contracts at April 30, 1932, to \$3,053,391.53.

This total is without respect to an amount which this witness referred to in his original testimony of some \$10,300,000 that went into the account in 1930 and was reversed, so to speak, in 1932 so that, if I may, we will simply disregard that total of that amount at this time.

Q. That was a valuation figure, was it not?

A. That is correct. The additions were made up of the totaling items—

Q. (Interposing) You are speaking about the additions—

A. (Continuing) —the additions raising the total from \$2,398,402.19 to the total at April 30, 1932, of \$3,053,391.53. They consisted of \$420,000 which represented the cost of 15,000 shares of Missouri-Kansas Pipe Line Company stock at \$28 per share in payment of which Panhandle Eastern Pipe Line Company issued, in compliance with action taken by its Board of Directors at a meeting held May 23, 1930, [fol. 7074] certain 5 year, 6 percent note or notes, and also an amount of \$136,000 to record the issuance of a 7 percent bearer note with no maturity mentioned in exchange for 4,000 shares of Missouri-Kansas Pipe Line Company stock at \$34 per share.

Apparently the first of these two transactions had to do with contracts with Illinois Power and Light Company and Missouri Power and Light Company or it may have been that the latter of the two items had something to do with those contracts.

There was a cash payment made by Missouri-Kansas Pipe Line Company to the American Coke and Chemical Contracting Company to reimburse them for their expenses in securing sales contracts with Keystone Steel & Wire

Company, Peoria Malleable Castings Company, Caterpillar Tractor Company and the R. Herschel Manufacturing Company.

There was a further disbursement for insurance premium on contract bond furnished in connection with the Keystone contract amounting to \$1,000. In addition, there were payments made to American Coke and Chemical Contracting Company for engineering fee and/or expenses in connection with the securing of the sales contracts with Keystone Steel and Wire Company, Peoria Malleable Castings Company, Caterpillar Tractor Company and the R. Herschel Manufacturing Company, as well as a small item of expenses amounting to \$786.30 of one of the officers of the [fol. 7075] company.

Q. Was that not Mr. Parish?

A. That is correct.

Then, for the period from September, 1930, up to and including sometime in 1932, there were expenses, general payroll expenses, attorneys' fees and so forth, amounting to \$12,703.04, all of which we added to the original amount, \$2,398,402.19, which aggregated \$3,053,391.53.

Now, subsequent to those transactions and I believe it was about the early part of 1936, the small amount of amortization recorded on the company's books with respect to gas sales and purchase contracts was applied as a reduction of the addition between the \$2,398,402.19 and the total \$3,053,391.53 so that as you observe in Column H on Line 40 of Page 2 of Exhibit No. 52, the balance was reduced to \$2,930,286.40 which is the amount now being amortized in conformity with the Certificate of Incorporation of Panhandle Eastern Pipe Line Company at the rate of \$24,419.05.

Is that sufficient detail before the witness proceeds, so far as the make-up of the charges are concerned?

Q. Yes. Of course, I anticipate discussing with you somewhat more in detail the several charges which you have mentioned.

A. Yes, I rather anticipate that myself.

Q. Yes, I would imagine so.

[fol. 7076] A. Now, to get back to the general viewpoint and description of the sum total of the items, it appears that there was received as a result of the contribution made by Missouri-Kansas Pipe Line Company, among other things, gas purchase contracts representing some 50,000-odd acres of gas-producing lands or lands which may not have become producing but, at any rate, there was apparently that number of acres involved and there were some 23 or thereabouts gas sales contracts involved.

Now, sales are not at this moment being made under each of such contracts but sales are being made to each of the purchasers represented by such contracts, either in the form of new contracts with them or in the form of rate schedules, so that, as a result of the sales in the manner described from September 30, 1930, to or about December 31, 1940, there has been a total revenue received by the company somewhere in the neighborhood of \$15,000,000.

Q. Do you mean from these—

A. (Interposing) From these companies or their subsidiaries under the contracts that were received as a part of the donation from Missouri-Kansas Pipe Line Company or from new contracts executed with them or from sales made to them under rate schedules.

Now, the new contracts, and please do not misinterpret that characterization because that does not mean a new contract with respect to some other uses necessarily but [fol. 7077] it might have well developed that there were circumstances making desirable the execution of a contract in some slightly different form. Regardless of how this total of \$2,930,000-odd came into existence or regardless of whether or not a part of it could properly be described as a write-up, if one chose to view it from that standpoint, there was some substantial importance in the thing received by Panhandle Eastern Pipe Line Company without cost to it and it should be represented in its records and affairs in some manner.

Now, if I may go back for a moment to my original statement, you probably drew the conclusion and properly so, that at the time this witness first noticed those amounts on the books of the company, he was of the opinion that perhaps there was nothing there but, I must say, sir, over the

width and breadth of my experience with the company and my knowledge of the benefits received from the rights represented by these so-called charges to gas sales and purchase contracts, whether they were received by Panhandle Eastern Pipe Line Company as a contribution or by any amount at which it was recorded on its books or by subsequent additions, that if I were qualified to properly place a value on such amount, it would be far in excess of any amounts at which those items are carried on the books of the company and that, I believe, sir, finishes my statement. [fol. 7078] Q. By your last statement, you indicate, do you not, that you did not consider yourself qualified to so evaluate these gas sales and purchase contracts?

A. I am not attempting to make any such evaluation, sir. I believe I have sufficient information concerning them to speak something with respect to their value.

I have observed the performance under them over all these years. I have known what the income from them meant to the company when dollars were far more scarce than they are at the moment and I believe I do have some very definite knowledge as to what they have meant to Panhandle Eastern Pipe Line Company.

I am not an expert with respect to the valuation of such items and I hope that is satisfactory for your purposes.

Q. By your explanation, Mr. Watkins, you have not attempted to indicate in any way, have you, that the various totals which you have read aggregating, in 1935 and for several years prior thereto; \$3,053,391.53 as shown in Columns D through G on Page 2 of Exhibit No. 52 at Line 40 and the total aggregate amount of \$2,930,286.40 as shown on this same line in Columns H through M as representing, in toto, expenditures made in connection with gas sales and purchase contracts either by Mo-Kan or by the Panhandle Eastern Pipe Line Company?

A. I am not so sure I understand just what you mean [fol. 7079] there.

Q. To put it succinctly, has your statement indicated in any way that these amounts to which I just made reference represent expenditures actually made by Mo-Kan or Panhandle Eastern Pipe Line Company?

A. I have no knowledge, Mr. Gorman, of the records of Missouri-Kansas Pipe Line Company. I can only speak

with respect to that as to the information that I have gleaned in searching out data with respect to this.

Q. Yes.

A. I am conscious of the fact that certain representations with respect to those expenditures have been made in certain reports filed in several different matters, so that so far as Missouri-Kansas Pipe Line Company is concerned, or the portion of such expenditures made by that company, I am not qualified to state anything with respect to the actuality of such expenditures.

So far as Panhandle Eastern Pipe Line Company is concerned, to the extent that it represents that it has made any such expenditure, I shall be very glad to assist you in any manner that I can.

* Perhaps this should be added to what has already been said: Panhandle Eastern and its subsidiary companies do not follow the custom or practice of charging to an asset account, capitalizing it, as you put it, all the cost incident [fol. 7080] to the acquisition by it of either gas sales contracts or gas purchase contracts.

As you may well imagine over the years we acquire a vast number of gas purchase contracts and if we were to have accumulated the cost of acquisition of all of those we would have had a sum far in excess of what is shown on the records.

Furthermore, gas contracts acquired in the ordinary course of business that require no contribution or payment to the selling company or to another company who may be selling to the distributing company, are not capitalized. There is a tremendous amount of expense incurred by the company in such effort that goes through operating expenses and does not necessarily become a part of a charge to any asset account and held for any gradual amortization.

I should not want the record to indicate that this witness has categorically stated that the amounts shown by any exhibits that he has presented represent all the dollars actually expended by Panhandle Eastern and its subsidiaries for this particular purpose. Are we clear there?

[fol. 7081] Mr. Wheat: Mr. Watkins, in connection with the statements that you have been making this morning, have you prepared a three-page document entitled, "Statement of Cost of Business Development—Period from April 1, 1932, to June 30, 1941", which contains details of the total of \$553,992.48 which, I believe, is the item which you gave to Mr. Biddison?

The Witness: I have prepared such a statement, or, rather, such a statement has been prepared under my supervision.

Mr. Wheat: And is the document which I now show you the statement to which you have just referred?

The Witness: It is.

Mr. Wheat: Mr. Examiner, it occurs to me, and I have discussed the matter with Mr. Gorman, that it might be advisable at this time to have the three-page document marked for identification in this proceeding.

Trial Examiner: This will be marked for identification as Exhibit No. 153.

(The document referred to was marked Exhibit No. 153 for identification.)

By Mr. Gorman:

Q. Mr. Watkins, in your statement of a short time ago with respect to these items we have been discussing, you referred to Table No. 2 as contained in the report prepared by Mr. M. C. Steele, an Examiner of the Federal Trade Commission, which has previously been identified in the [fol. 7082] proceeding as Exhibit No. 6575 as contained in Federal Trade Commission Report 84-1 to which reference has been made previously; which table is shown at page 1195 of this volume, and I believe you also referred to the difference between the amount which is purported to have been carried on the books of the Missouri-Kansas Pipe Line Company for gas contracts totaling \$926,250, which was subsequently recorded on the books of the Panhandle Eastern Pipe Line Company at a total of \$2,398,402.19.

Now, you made some reference to the difference in these figures shown on this Table No. 2, which is purported to be

\$1,472,152.19 as distinguished from a total of \$1,292,152.19 which you read into the record.

A. What was the last amount, please?

Q. \$1,292,152.19. Isn't that correct?

A. I believe there must be some confusion, Mr. Gorman. First, the witness has previously identified the table from which you quoted in the Federal Trade Commission report as being substantially the same as Table No. 2 on page 17 of Mr. Steele's report with respect to Panhandle Eastern, has he not, so if you refer to that table and the witness refers to this, we are unquestionably speaking about the same table?

Q. Yes, they are identical tables, Mr. Watkins.

A. Now, I believe the thing that is just slightly confusing here is this: At the time Panhandle Eastern made the entries recording the gas sales and purchase contracts acquired from Missouri-Kansas Pipe Line Company, it apparently had knowledge of the fact that Missouri-Kansas Pipe Line Company carried those amounts on its books at \$1,166,250 rather than the \$926,250 referred to by Mr. Steele and, in the proceedings this morning, the witness has stated that, while there was such a difference, no one of the people connected with Panhandle Eastern Pipe Line Company had any knowledge as to the exact thing that gave rise to the difference.

There may very well have been an adjustment of some sort made by Missouri-Kansas Pipe Line Company on its books subsequent to September 30, 1930, but before the examination referred to in Mr. Steele's report, or whoever made the report, with regard to Missouri-Kansas Pipe Line Company.

Q. Will you please refer to page 19 of this report of Mr. Steele to which you are referring. Do you note on that page that there is contained a summary of gas contracts as recorded on the books of Missouri-Kansas Pipe Line Company? A. I do.

Q. Do you note also that there is contained in such summary the following statement:

"Less portion of gas contracts acquired at organization and credited to capital surplus written off, \$180,000", which [fol. 7084] results, when deducted from the total of \$1,

106,250, in the total stated ledger value of gas contracts as of August 31, 1930, of \$926,250, which is the same amount referred to in Table 2 on page 17 of that report?

A. Those facts are shown on page 1196 of Mr. Steele's report with respect to Panhandle Eastern, but the witness wishes to differ in at least two directions with the material shown there.

In the first instance, I must make it clear that in any statements I have made during the proceedings this morning, or heretofore for that matter, with regard to gas sales and purchase contracts, and the amount at which they are carried on the books, that I have in no wise intended to give any indication that it was my view that the ledgers or the records state values.

Secondly, although I do not know the exact date of the adoption of Senate Resolution No. 83, nor do I have at this moment the exact date of the examination by Mr. Steele or any other member of the staff of the Federal Trade Commission of the books and records of Missouri-Kansas Pipe Line Company nor, for that matter, do I recall the absolute dates upon which such examination was made by Mr. Steele and his assistants of the accounts and records of Panhandle Eastern Pipe Line Company, it is still my opinion, from the information I have thus far been able to determine with respect to the \$1,106,250 item or the \$926, [fol. 7085] 250 item, as shown in this table, as you have stated, that the adjustment could have very well been made subsequent to the date it was recorded on the books of Panhandle Eastern Pipe Line Company or, for that matter, subsequent to August 31, 1930, the date shown on page 19 of the report to which we have just been referring.

Q. By that do you intend to create the inference that, insofar as your knowledge goes, such write-off of \$180,000 was not made prior to August 31, 1930, as of which date the property was transferred to the Panhandle Eastern Company?

A. No, sir, your statement is wrong in two respects. First, the witness makes no effort to characterize the difference of \$180,000. I believe it is, as a write-off. Mr. Steele does that, and Mr. Steele speaks for himself.

Secondly, the position the witness has been trying to take and show you is that at the time Panhandle Eastern

Pipe Line Company made the entries recording on its books amounts at which it was to carry the sum total of approximately \$19,300,000 of assets received as a capital contribution from Missouri-Kansas Pipe Line Company, the amount of \$1,106,250 was based on such entries. Whether that be correct or not, is an entirely different thing.

Q. Is it true that the first recordation on the books of Panhandle Eastern Company of this item was in the amount of \$2,398,402.19?

[fol. 7086] A. Yes, sir, that is correct.

Mr. Wheat: May I ask, Mr. Watkins, at what date that entry was made? Do you have that?

The Witness: I do not have the actual date. My remembrance is it was the very first journal entry made by Panhandle Eastern Pipe Line Company, or perhaps the second entry made by Panhandle Eastern Pipe Line Company, at the time all of these assets were received by it as a capital contribution from Mo-Kan back in the year 1930.

Mr. Wheat: In other words, it was synchronous with that transaction, is that true?

The Witness: Quite.

Mr. Wheat: Yes, thank you.

Pardon me, Mr. Gorman.

The Witness: It can very easily be found in the company's records.

By Mr. Gorman:

Q. Do you know whether or not, Mr. Watkins, this amount of \$2,398,402.19 represented a valuation made by the Board of Directors at a board meeting held on February 3, 1931, of gas sales and purchase contracts acquired from the Missouri-Kansas Pipe Line Company as of August 31, 1930, without consideration being paid therefor?

A. Mr. Gorman, our entries are actually a little ahead of the Board of Directors' in this instance. The entries [fol. 7087] were made in 1930 and the meeting of the Board held on February 3, 1931, and in the manner the witness has heretofore testified. Whether the Board's use of language in its determination was provident or improvident, the Board did authorize or approve or ratify or

confirm, if you please, the making of what the Board said were certain valuations, but, regardless of what the Board then said or may thereafter have said or may in future say with respect to valuations, it is the position of this witness that books, records, and accounts cannot, except by mere coincident, show valuation, and I doubt if such a coincidence can ever exist.

Q. Well, who, according to your knowledge and information, determined the amount which was, as you stated, set up on the books of the company prior to this so-called valuation by this Board of Directors at their meeting on February 3, 1931?

A. May the witness have this understanding with you, sir, and for the record, that he believes will simplify the response to the questions, that in any sense that you refer to this as a "valuation" and in any response this witness gives in respect to this item, he will not be agreeing with your statement that it does represent value. If we can have that understanding, it will remove the necessity of any qualifications of my answers hereafter as to this item.

Q. That may be so understood but, in that connection, [fol. 7088] if you dislike the term "valuation", what would be your preference in the matter?

A. The amount assigned to this particular item at which it shall be carried on the books of the company.

Q. Which, in your opinion, would have no relation whatsoever to value?

A. This witness has repeatedly stated, sir, that he does not believe that books and records can ever show value.

Q. Yes. With that understanding, can you answer the question which I previously put?

A. My investigation and my remembrance of the multiplicity of things that have passed through my mind in connection with the original entries and the basis upon which such original entries may have been reached or the basis upon which the seller and purchaser may have had some agreement, is that, whoever drafted the original entries recording these items was interpreting, if you please, to the extent that the amounts included in such original entries did not actually represent amounts on the books of Missouri-Kansas Pipe Line Company or its subsidiaries, what he believed was the amount at which the so-called gas sales and purchase contracts were included in the agreements or

discussions before or after the September 17, 1930, contract.

As to the exact individual who made the entry, I am in about as big a fog as you are. I should like to ask that [fol. 7089] gentleman some questions myself, but he seems to be as nonexistent as a dodo.

Does that answer your question, sir, with respect to the origin of the amount that became a part and parcel of the original entry?

Q. I think it does, yes.

And from your last statement, I infer that you have, in times past, made an effort to ascertain the name of the individual who, shall we say, set up the various amounts which were originally entered on the books of the Panhandle Company as representing the recorded value of the property and other assets acquired from the Mo-Kan Company?

A. Prior to the action on February 3, 1931, by the Board of Directors?

Q. Yes.

A. I may have confused you slightly there. The witness believes he could actually ascertain the person who did the mechanical job of making up the entry after somebody else had arrived at what the entry should be.

Q. You mean the actual one who made the entry on the books?

A. I think that person could be found and, as a matter of fact, it is quite probable the entry itself would show his initials on that entry, because our entries are rather full in that respect. As a matter of fact, all of the entries, [fol. 7090] all of the journal entries made by the company since I have been connected with it, I believe, bear my initials, so that I would have to have responsibility for that. Back in the early stages of our affairs, we may not have been so careful in that respect or we may now be too careful.

The gentleman I should like to reach to clear up a few things in my mind, or should have liked to have been able to reach over the past years to clear up a few things in my mind. For gentlemen, if you please, if such were the condition, were the person or persons who determined this

amount of \$2,398,402.19 which I now believe is very, very inadequate.

Q. Yes. Well, of course, we are both speaking about the same people.

Do I understand that you have made, in the past, some effort to ascertain the name or names of this individual or these individuals who made such determinations, and by that I am speaking of those, other than the ones who actually made the bookkeeping entry?

A. Yes, we have desperately tried to learn as much as we possibly could about this item. Experience has taught us possibly more about what the item is worth to the company than had we been able to question anyone who had to do with the original entry.

Q. Despite whatever conclusions you may have subsequently reached, they have not resulted in a restatement of [fol. 7091] this amount on the books of the company?

A. They have not.

Mr. Gorman, I should, no doubt, in justice to our independent public accountants who have certified to examinations of the company's affairs over the period of years, state that most of their reports have some statement of the nature this witness referred to in his testimony last week, the necessity of which is manifested in the requirements of certain of the reports to be made to other governmental commissions, but their exceptions, if any, to the item were not of a nature to cause its removal from the books and records of the company.

Q. In that connection, Mr. Watkins, have you or any others of the official staff or the other employees of the company ever caused anything to be removed from the books of the company?

A. That is such a broad question that I do not think one could answer it.

Now, you do not mean, I am sure, improper removals?

Q. No, I am not impugning anything like that.

A. There have, no doubt, been a vast number of items removed from the books through the normal processes of accepted accounting practices consistently followed.

Q. Have there been any such removals occasioned by the request of Arthur Andersen and Company or other accountants who were auditing the books of the company?

[fol. 7092] A. I could not answer such a question as that off the top of my head, sir. I must say in response to that simply this: Panhandle Eastern's officers charged with its accounting affairs have tried to work as closely as they possibly can with the company's public accountants, and if the public accountants, in some form or fashion, appear critical of some charge, shall we say, either to operating expenses or to gas plant, which their judgment would seem to indicate should go to the other account, we have had such discussions as any conditions of that nature might warrant and have properly disposed of the item. You just cannot answer a question such as you have put in any concrete fashion.

Now, if the question were somewhat along this line—Does this witness know of any important instance in which, as the result of a request, a suggestion, or whatever you please, by its public accountant or by any body having competent jurisdiction?—then the answer would be unqualifiedly no.

Is that the avenue down which we are trying to drive?

Q. I think so.

A. Are you conscious of the fact that with respect to the gas sales and purchase contracts following some of the transactions that were consummated in the early part of 1936, perhaps as of December 31, 1935, some \$600,000-odd of the original \$3,053,391.53 was written off to reserve?

[fol. 7093] Q. Is that shown in any of the exhibits which you have introduced in this case?

A. The effect is certainly shown. Whether it is specifically shown in any of the exhibits, I do not recall at the moment, but the fact is simply this, and I think I touched on it this morning, amortization of the gas sales and purchase contracts originated in the early years and continued at a rather slow pace, shall we say, up to the beginning of 1936 at the time of the Certificate of Amendment in which was a provision that we must amortize the residue of the gas sales and purchase contracts or the amount of \$2,398,402.19 at the rate of \$24,419.05 per month, the reserve previously created and the difference between the \$2,398,

402.19 and the total amount of \$3,053,391.53 was disposed of through appropriate entries at that time.

Q. Where is the effect of that reflected in the exhibits presented by you?

A. On page 2 of Exhibit 52 at line 40, column H.

Q. Does that complete your answer, Mr. Watkins?

A. Yes, sir.

Q. And I believe you referred to a figure of approximately \$500,000. As I note the difference and I believe you also referred only to line 40, did you not?

A. I did refer to line 40.

Q. As I make that calculation, the difference between [fol. 7094] the figures shown in column H for 1936 and that shown in column G for 1935 is only \$123,105.13, which appears to be the amount set forth at line 42 in column G.

Now, what or where is shown the difference between that \$123,000-odd and the approximately \$500,000 which you mentioned?

A. Counsel will observe opposite line 42 on page 2 of Exhibit No. 52 certain amounts of reserves in the years 1932 to 1935 or, specifically, columns D, E, F, and G, which were applicable, as has been previously stated, to the \$3,053,391.53 amount.

[fol. 7095] Q. Are the amounts shown at Line 42—

A. (Interposing) I am sorry, I had not finished if you please.

Q. I thought you had.

A. This reserve, or rather these reserves were first applied to the asset account and the residue was then written off and the witness is sorry he does not have before him at this moment an explanation of just how that entry was made.

I shall be very glad to get it and supply the information.

Q. Will you undertake to do so, please. A. Yes, sir.

Q. I personally am still somewhat confused with respect to the application of the amounts shown at Line 42 to the amounts shown at Line 40 on this Page 2 of Exhibit No. 48.

First, let me ask you this, whether or not the amounts shown at Line 42 for the respective years do not represent the balances as of December 31; of each of those years?

A. They do.

Q. Does the \$123,105.13, as shown in Column G on Line 42, represent the balance as of December 31, 1935, which, apparently, from the amounts shown as remaining in the gas sales and purchase contracts asset account at December 31, 1936, was apparently applied to that account in the year [fol. 7096] 1936? I am still somewhat at a loss to understand your statement with respect to a figure of approximately \$500,000 which was applied during this period. Maybe you can enlighten me further with respect to that.

A. I do not recall the \$500,000 figure, sir, and the witness has volunteered to obtain the information as to what happened to the difference between the \$600,000 odd item and the accumulated reserve of, I believe you said, \$123,000 and until I can obtain such information, I cannot enlighten you further.

Q. Very well. We shall let it go at that.

Mr. Wheat: I think, Mr. Gorman, when you referred to a \$500,000 figure, you were intending to refer to the \$600,000-odd figure that the witness had previously mentioned.

Mr. Gorman: That apparently is correct.

Mr. Wheat: Yes.

By Mr. Gorman:

Q. Now, Mr. Watkins, if you will please refer to Line 40, Column H on this page which indicates that there was a balance at December 31, 1936, in the reserve for amortization of gas sales and purchase contracts of \$295,731.30. Does that indicate to you that this amount was accrued during the year 1936 to this reserve account?

A. Accruals to this reserve account began as of January 1, 1936, at the rate of \$24,419.05, continued constantly [fol. 7097] throughout that year and, for that matter, have continued constantly at that amount to this date and the \$295,731.30, to which you have just referred, shown opposite Line No. 42 in Column H on Page 2 of Exhibit No. 52, must unquestionably represent the total accrual at the monthly rate heretofore stipulated for the year 1936.

Q. Yes.

A. Likewise, the totals shown on the same line on the same page of this same exhibit, in Column I, J, K, L and M represent the accumulation of such accruals at that rate at the dates represented by such columns.

Q. To what extent is the total appearing as of June 30, 1941, which is shown at Column M, Line 40, of Page 2 of this Exhibit No. 52 shown in Exhibit No. 48 at Line 1 of Page 1 of Exhibit 48, Column M, that is, in the gas plant account?

A. The net difference between the amounts carried at Line 40—we are speaking now of June 30, 1941, are we?

Q. Yes.

A. In Column M of Page 2 of Exhibit No. 52, the amount \$1,611,657.30 shown opposite Line 42 in the same column is represented as a part of the \$66,689,669.57 shown as gas plant at Line 1 of Page 1 of Exhibit No. 48 in Column M at June 30, 1941.

The reason for that treatment, Mr. Gorman, is simply [fol. 7098] this: Company officials and general counsel for the company have interpreted the language of the Certificate of Incorporation in such manner that we are precluded from applying the reserve, as created, to the asset account.

Otherwise, it would have likely been our practice to have taken these amounts as they were created each month or certainly, shall we say, at the end of each year and have applied them to the asset account.

We did that with respect to the amounts shown opposite Line 44 on Page 2 of Exhibit 52 or, said differently, both types of gas sales and purchase contracts are reflected opposite Line 1 in Exhibit No. 48 at the various dates for which information is there shown net.

However, in the one instance, shown broad on Exhibit 52 and, in the other instance, net.

Q. Can you also explain to us why the full amount assigned to these gas sales and purchase contracts, as reflected on Line 40 of Page 2 of Exhibit No. 52 is not, in toto, reflected in the gas plant account as an asset and the reserves also reflected on Page 2 of Exhibit No. 48 as a liability in conformity with the treatment given to other similar items in the balance sheet?

A. Mr. Gorman, there are no other similar items—

Q. (Interposing) Other similar reserves, then.

A. (Continuing) —in the balance sheet. These re- [fol. 7099] serves are quite a different "breed of pups"

from a reserve for depreciation. These amounts have been taken out of earnings to represent the gradual amortization of an asset.

It could very well be that they are improperly called "reserves".

In the instance of the gas sales and purchase contracts shown opposite Line 44 in Columns H, I, J, K, L and M of Page No. 2 of Exhibit No. 52, our accounting treatment has been to reduce the asset account by the amortization taken in each year.

As a matter of fact, my remembrance is that we do that monthly in our entries for that particular month and this witness has shown, by previous answers, that his preference with respect to the other gas sales and purchase contracts would have been to have accorded those the same treatment as new gas sales and purchase contracts.

Our interpretation and the interpretation of the company's general counsel of the requirements of its Certificate of Incorporation is such that we cannot give such treatment, that we must maintain this reserve until there has been created a total of \$2,930,286.40 if the Certificate of Incorporation is not amended to cause different treatment in the meantime and, at that time, charge the asset account to the reserve account and wipe it out.

[fol. 7100] There is no significance, if you please, in the variation of treatment between these reserves and the method of showing other reserves in Exhibit No. 48. As a matter of fact, we thought we were being rather nice to the Commission in putting them up in this form. We thought it was informative and probably what the Commission wanted.

Q. By that do you mean that the balance sheet which you have presented here as Exhibit No. 48 is different from the balance sheet which you customarily prepare for other purposes?

A. Yes, it is as to form and, I believe we have covered that ground before. This will be at least the third time that this witness has stated, if you do not stop me, that our effort in the construction of the exhibits that were introduced through him was to conform them as nearly as

we [possible] could to what we understood the requirements of the Federal Power Commission were.

There is no restriction, as far as this witness knows, in any regulation that this company is subject to that it may not treat, in a balance sheet, these items or any other assets in any conventional form which may at the time be acceptable.

This witness has also stated heretofore in these proceedings that when securities are listed on the New York Stock Exchange the company listing such securities must make [fol. 7101] certain representations with regard to the manner in which it is going to continue to supply information contained in annual reports to its stockholders so, in reporting annually to our stockholders the amounts invested in gas plant, we have not even included this item of gas sales and purchase contracts. It had been set out entirely separate under a heading called "Intangibles" and the reserve accumulated at the end of that period has been deducted therefrom and the amount has been shown entirely separate.

Q. But Exhibit No. 48 is, is it not, a reflection of the accounts as shown on the books of the company?

A. It is a reflection of the accounts, not necessarily as the accounts are shown. There are, of course, in the records of any corporation most always far more accounts than can be included in the balance sheet.

Q. Well, of course, I was referring to controlling accounts and those, of course, are the ones which are shown on the balance sheets.

A. There may be groupings, even, Mr. Gorman, of controlling accounts. There is no effort on the part of Panhandle Eastern Pipe Line Company to actually restrict its records to such a point that one could go to the records and instantly pull off information in the exact form in which it is shown in Exhibit No. 48 or any other balance sheet that may be prepared for the company and from my experience, that is most always true in any organization that you encounter. [fol. 7102]

Q. Now, Mr. Watkins, you have, from time to time, in connection with these gas sales and purchase contracts and

the amortization thereof, referred to provisions in the Certificate of Incorporation, as amended.

Will you please undertake to supply for us copies of the Certificate of Incorporation and the several amendments thereto?

A. Subject to your choice, I shall either do that or read the applicable portion of the Certificate of Incorporation, as amended, into the record.

[fol. 7103] By Mr. Gorman:

Q. Now, Mr. Watkins, continuing our discussion of the amounts shown at Line 40 of page 2 of Exhibit No. 52 for gas sales and purchase contracts, do I understand your testimony of this morning correctly that you did not designate this \$2,930,286.40, which is shown in this exhibit for this account, as either a valuation or as representing cost directly attributable to the acquisition of such contracts, is that correct, but is merely, at least to the extent of \$2,398,462.19, an assignment which has been placed upon the books of the Panhandle Eastern Pipe Line Company? Is that a correct summation of your testimony this morning?

A. I am afraid not, sir.

Q. In what respects is it erroneous? Maybe we had better break that down into this fashion: Do I understand correctly that you do not represent this amount of \$2,930, [fol. 7104] 286.40 as representing costs to either the Missouri-Kansas Company or the Panhandle Eastern Pipe Line Company of acquiring the various gas sales and purchase contracts represented by this amount?

A. This witness has made no such representation. As a matter of fact, the testimony given this morning shows that there was a portion of the \$2,930,286.40, shown on Line 40 at Column M of page 2 of Exhibit No. 52, that came into existence perhaps, although I cannot state too categorically that that is the condition without reference to cost to either Panhandle Eastern or Missouri-Kansas. I do not believe there is any misunderstanding between us as to that.

You will recall this morning that we spoke of a difference, both between a portion of this amount between the books of Panhandle Eastern and Missouri-Kansas Pipe Line Company and, further, that we dealt with an amount

that was assigned, at the time that the original increases were made, to gas sales and purchase contracts over and above any amounts that the records might show at that time were costs.

Q. Yes.

A. Now, as to valuation, my statements have consistently been that the records cannot, in my conception of values, show valuations. Further, the testimony this morning will [fol. 7105] show that in my own estimation the effects of the receipt by Panhandle Eastern of whatever contracts for whatever rights it received among the assets donated by Missouri-Kansas Pipe Line Company, aggregating some \$19,300,000 flowing from the instruments or the medium or whatever it may be that is now recorded on the books of the company as a part of the gas sales and purchase contracts, is substantially in excess of any amount shown by the books. I went further, of course, to state that I probably could not qualify as an authority to make such valuation.

Q. Now, Mr. Watkins, will you please refer to the report which was prepared by Mr. Steele, the Federal Trade Commission Examiner, and particularly to page 19 thereof, which is shown at page 1196 of Volume 84-I of the Federal Trade Commission reports which we have been discussing, and for the purpose of the record read from the report which you have, commencing on page 19, the paragraph which commences, "A summary of gas contracts as recorded on the books of Missouri-Kansas Pipe Line Company."

Do you find that?

A. I do.

Q. Will you please read that and the paragraph which follows such summary?

A. Without adopting the paragraph counsel has referred [fol. 7106] to as the witness' own testimony, the matter referred to follows:

"A summary of gas contracts as recorded on the books of Missouri-Kansas Pipe Line Company follows:

"Valuation of gas contracts acquired at organization of Missouri-Kansas Pipe Line Company. \$ 880,000

"Non-producing leaseholds held by Missouri-Kansas Pipe Line Company assigned to affiliated companies for certain gas purchase rights.....\$ 225,000

"Legal fees.....\$ 1,250

The sum of those three items is shown in this tabulation as.....\$1,106,250

"Less:—"

Q. (Interposing) Mr. Watkins, what did you state the legal fees to be there? A. \$1,250.

Q. Oh I understood you to say \$550.

A. (Continuing)

"Less: Portion of gas contracts acquired at organization and credited to capital surplus written off.....\$ 180,000"

There then remains an item shown here as [fol. 7107] "Ledger value of gas contracts as of August 31, 1930.....\$ 926,250."

Q. Now, will you please read the paragraph which succeeds the summary you have just read?

A. "The value placed on gas contracts at the organization of Missouri Gas Pipe Line Company was credited to capital surplus in the amount of \$180,000 and the remaining \$700,000 was offset by the stated value of common stock issued to the organizers without cost to the latter. The non-producing leaseholds assigned to affiliated companies for certain purchase contracts were acquired in a similar manner from Messrs. Shippey, Madden and Parish, who organized and controlled Missouri-Kansas Pipe Line Company."

"Consequently, it appears that except for legal fees the amount of gas contracts shown on the books of Missouri Gas Pipeline Company did not represent actual cost, but merely book figures reflected in the stated value of common stock issued," which ends the paragraph referred to.

Q. Thank you.

Now, have your investigations, which you indicated this morning you had made with respect to this item, led you to any conclusions with respect to the statements which

[fol. 7108] you have just read from this report of the Federal Trade Commission!

A. They have not. I have been conscious of this statement, very naturally, since the report was first in draft form.

The practice followed by the Federal Trade Commission Examiners was to submit to the companies the draft of their report, the companies had the right to examine it, offer comments, criticism, and so forth, and Panhandle Eastern was accorded this privilege and did act upon it, but with the specific understanding that by so doing it was simply attempting to assist the Examiner in getting his facts correct, but was not in any manner whatsoever adopting the statements made by the Examiner.

Now, this witness' examination of these amounts, very naturally, has been circumscribed by data available to the company subsequent to the acquisition of this and the other items from Missouri-Kansas Pipe Line Company's capital contribution.

We have had no access to their books or records, so that speaking from my own personal standpoint I have no definite information upon which to either base a concurrence of the facts stated by Mr. Steele in the paragraph we have just read, nor to take issue with the statements stated therein.

[fol. 7109] Q. Do you know whether or not any attempt has been made by anyone connected with the Panhandle Eastern Company to obtain access to the books and records of the Missouri-Kansas Company for the purpose of examining them in so far as they touch upon the items which we are now discussing?

A. I made a trip to Chicago during the time Missouri-Kansas Pipe Line Company was in receivership for the particular purpose of trying to eliminate some difference between the receivers and Panhandle Eastern Pipe Line Company as to amounts that were in controversy of what we knew at the time as the Missouri-Kansas open account. This was an account that came into being about the time the properties we have referred to many times in these proceedings were received from Missouri-Kansas and that had for its purpose the receipt of charges and credits to

Missouri-Kansas arising through the transition of the assets or liabilities from their records to the records of Panhandle Eastern.

My remembrance at the moment is that the total amount involved there was some \$40,000, which later, by the way, Panhandle Eastern absorbed.

When discussing these items with Mr. C. R. Phillips, the Chicago Receiver of Missouri-Kansas, and his assistant—there may have been one assistant—my very distinct remembrance is that the books and records of Missouri-
[fol. 7110] Kansas at that time were in a very disturbed state of affairs. I remember rather vividly walking into some storerooms in the basement of the building in which they had their office and being terribly shocked at the condition of the records lodged there. Without any idea whatsoever of casting any disparaging remarks in any direction, I recall that some offhand statement was made, "This is what the Federal Trade boys do to your records."

It was very difficult to ascertain any facts with respect to the items and there were a great number of them, both charges and credits that made up the balance of some \$40,000, so that the purpose of my trip there was a complete bust.

[fol. 7111] Now, subsequent to that time in the preparation of registration statements and for other purposes we have requested certain information of the officials of Missouri-Kansas Pipe Line Company or of the receivers. Not only that, but the public accounting firm, who has made the audits of Panhandle Eastern Pipeline Company's records and the records of its subsidiaries, happened to have been the accounting firm that was employed by Missouri-Kansas Pipeline Company for some of its affairs prior to September 30, 1930 and they may have done some work for them subsequent to that time, and they made inquiry, I believe, and possibly searched some of their working papers for whatever items of any nature Panhandle Eastern had occasion to try to examine with respect to the books and records of Missouri-Kansas.

Specifically as to the items in question here, we have not made a great amount of investigation for the very reason that it did not seem to us over the period of years, as I now

recall, that any demands might have been made during those years, had any great importance to what the amounts were on the records of Missouri-Kansas Pipeline Company. There is a very definite beginning of the amounts, as to Panhandle Eastern Pipeline Company's records, commencing with September, 1930, which were, as we have heretofore spoken of today, concurred in by the Board of Directors at [fol. 7142] a meeting held sometime in February, 1931.

We are in the process, as you know, Mr. Gorman, of making a response to this Commission's Order No. 73 with respect to original cost. We hope to be able to say to the Commission that these items represent cost to the companies first devoting them to public service. I can not assure you that that fact will be the final outcome of our preparation. It might be noted here that the period in which we were to make a report under the Commission's Order No. 73 has been extended to March 31, 1942, although our request was for an extension beyond that date and this witness is at this moment very much of the opinion that it will be totally impossible to meet the March 31, 1942 date.

I hope that that rather long statement was responsive to the question you asked.

Q. Yes, I think we finally got the answer.

Well, have your studies of this original cost statement to be submitted to the Commission included, as yet, any consideration of the items we are now discussing?

A. In a general way only.

Q. In other words, you have not yet completed your study with respect to such items?

A. Well, we have not yet completed our study with respect to original cost as a whole and I should like not to be forced to make any statements with respect to original [fol. 7113] cost as we may finally conclude from our studies at this time.

Q. So that as of the present time you do not consider yourself in a position to state what portion, if any, of this \$2,930,286.40 represents cost?

A. I think that is correct.

Q. Now, the items which were referred to and the statements which you read from the Federal Trade Commission

report are those same items, are they not; which were subsequently—in view of your previous statements I find it difficult to refer to that in any manner except that of an assignment of \$2,398,402.19?

The Witness: May I have that question, please?

(Pending question read by reporter.)

The Witness: They are.

By Mr. Gorman:

Q. And that amount, of course, of \$2,000,000 odd is entered on the books of your company as a contribution of capital from Missouri-Kansas; is that correct?

A. The effect of the entry on the credit side of the ledger took that position, yes.

Q. That is what I am speaking of.

Now, in addition to this amount of \$2,398,402.19, is there not a further entry on the books of the Panhandle Eastern Pipeline Company in the amount of \$642,286.30, to which I believe you have previously made reference in your state-[fol. 7114] ments?

A. That amount I do not believe constituted one single entry. There were, and the record of this morning's proceedings will show there were, several items making up that amount.

Q. Yes, I so understood. Now, let us consider each of those several entries. A. All right, sir.

Q. Is the first such entry, in the amount of \$556,000, representing notes issued for purchase of Missouri-Kansas Pipe Line Company's stock, used in connection with obtaining gas sales contracts?

A. My analysis of the account shows the \$556,000 in two items.

Q. One of which was \$420,000 and the other was \$136,000? A. That is correct.

Q. And is your analysis in conformity with the books of your company, that is to say, is it set up there as two amounts or one amount?

A. Those two amounts, plus several other amounts, made a part of the record this morning, as well as the \$2,398,402.19, to which we have made reference a number of times, constitute a portion of the entries in one account,

which, for convenience, the company thinks of as gas sales [fol. 7113] and purchase contracts, -old. It is not so characterized, but the residue of all of those entries is shown line 40 at page 2 of Exhibit No. 52, in column M.

Q. Now, does this first item of \$420,000 represent a transaction in May of 1930 whereby five year, 6 per cent bearer notes were given in payment for 15,000 shares of common stock of Missouri-Kansas Pipe Line Company at \$28 per share for use in connection with obtaining gas sales contracts with Illinois Power & Light Corporation and Missouri Power & Light Company? A. It does.

Q. And were these notes issued pursuant to authorization of the Board of Directors of the Panhandle Eastern Pipe Line Company at a meeting held on May 23, 1930?

A. They were. I believe, although I can not find it at this moment, I have an excerpt from the minutes of that meeting.

Q. May I invite your attention, Mr. Watkins, to page 41 of the Federal Trade Commission report prepared by Mr. Steele and ask you whether or not that is the excerpt of the minutes of which you were speaking?

A. Well, obviously, you would not expect me to remember the exact language from the minutes, but the excerpt shown here on page 41 does appear to be, as best I can recall, the exact precise language taken from the minutes of a meeting of the Board of Directors of Panhandle Eastern Pipe Line Company held May 23, 1930.

Q. Yes.

With the Examiner's permission, I shall propose to read into the record this excerpt to which we have just been making reference with the understanding that Mr. Watkins may consult the official minutes of the company and make such corrections as may be necessary to conform thereto.

Trial Examiner: You may proceed.

By Mr. Gorman:

Q. The excerpt which I propose to read appears at page 1206 of Volume 84-1 of Federal Trade Commission report, which is the same as page 41 of the report prepared by Mr. Steele to which I made reference a moment ago and reads as follows:

"The president stated that under date of May 19, 1930 the company had entered into contracts with Illinois Power & Light Corporation and Missouri Power & Light Company under the terms of which said companies had agreed to purchase natural gas from this company for the purpose of supplying the gas requirements of Decatur, Danville, Urbana, Champaign, Jacksonville and Clinton, Illinois, and Jefferson City, Boonville, Excelsior Springs, Moberly, and Mexico, Missouri and that in connection with the obtaining of said contracts commitments had been made requiring [fol. 7117] 15,000 shares of common stock of Missouri-Kansas Pipe Line Company.

"Thereupon, upon motion made, seconded and carried, the following resolution was unanimously adopted;

"Resolved, that the officers of this company be, and they are hereby, authorized and empowered to purchase from Frank P. Parish and Company 15,000 shares of common stock of Missouri-Kansas Pipe Line Company, at the price of \$28 per share, and to give to said Frank P. Parish and Company in payment of said purchase price the promissory note of this company dated May 23, 1930 in the sum of \$420,000, payable five years after date, bearing interest at the rate of 6 per cent per annum; and be it further

"Resolved, that the president of this company be, and he is hereby, authorized and empowered to make such use of said 15,000 shares of stock of Missouri-Kansas Pipe Line Company so purchased as he may deem advisable and in the best interests of the company."

Mr. Watkins, do you know whether or not such transaction was actually consummated, that is, the purchase of 15,000 shares of common stock of Missouri-Kansas?

A. I have no definite information with respect to either the purchase of that stock or what may have been done with it if it was purchased. My belief is that it was purchased and that some distribution was made of the stocks so purchased. As a matter of fact, I believe throughout the history of the company we have come across divergent views in certain instances as to what happened with that stock and whether it was what should have happened to it. As far as the company is concerned, here is the record.

The notes were issued for the purpose the Board authorized them to be issued. They were eventually paid. I presume the stock was purchased; I also assume that it was distributed. Further than that, I have no specific knowledge and I am sure you do not want any hearsay from me concerning the transaction.

Q. No. Do your statements indicate, Mr. Watkins, or is it your intention to so indicate that the records of the Panhandle Company do not show whether or not the stock was actually acquired and, also, do not show what disposition was made of it, if it was acquired?

A. Mr. Gorman, this witness has never been able to find in the record of the company any specific matter of the nature that he could answer your question other than that it would appear that the stock was purchased and distributed.

There have been responses, I believe, in some litigation, the exact details of which this witness is not too familiar with, which would tend to indicate that some distribution [fol. 7119] was made. We have referred a number of times to Mr. Steele's report and I believe Mr. Steele purports to have some information as to what disposition was made of the stock. Whether that squares with the facts or not, frankly, I do not know.

[fol. 7120] Q. Do the records of your company show that some time subsequent to May, 1930, payment was made by the Panhandle Eastern Pipe Line Company upon the note which was issued for the purchase of these 15,000 shares of Missouri-Kansas stock?

A. I am quite positive that those notes were paid. At this moment I do not know when nor how nor to whom, but, obviously, the obligation has been discharged.

Q. Yes. Well, then, may it not be properly inferred that in so far as the books and records of Panhandle Eastern Pipe Line Company are concerned, that the only data which they would have respecting this transaction would be the minute which we have read into the record and possibly the record of the issuance of the note and, subsequently, the payment of the note?

A. So far as this witness is concerned, Mr. Gorman, I believe we can go a step or so further than that. Prior to September 30, 1930, Panhandle Eastern Pipe Line Company

was wholly-owned by Missouri-Kansas Pipe Line Company. The two items which we have just been referring to came as a result of action taken by the Board on May 23, 1930, and then there was an entry made on June 30, 1930, with respect to \$136,000 and it could very well be that there is in existence somewhere and intended for Panhandle Eastern Pipe Line Company's records an accounting to it of the [fol. 7121] disposition of the shares we purchased.

If you understand what I am trying to say, it is simply this: That Missouri-Kansas Pipe Line Company may have carried away from the offices of Panhandle Eastern Pipe Line Company after September 17, 1930, or subsequent to the closing date of the matters covered by this September 17, 1930, contract, as amended, some of the material that rightfully belonged to the record of Panhandle Eastern. It would be very foolish for anyone, I believe, to state that there never was such an accounting, although, as I started to indicate, my feeling is that I should go so far as to tell you that I have never found anything in the records of Panhandle Eastern that shows disposition other than, perchance, it be some statement made by some witness in the record of some proceeding or some deposition or correspondence of some general nature, the exact form of which I would not recall at this moment nor would I definitely recall whether I have ever seen any such statements.

That gives you a rather definite answer, doesn't it?

Q. Yes, I think so. Of course, I assume you are referring to statements and testimony contained in this volume of the Federal Trade Commission reports which we have mentioned and other volumes of reports prepared for the same purpose?

[fol. 7122] A. Oh, anywhere they might chance to be.

Q. Yes. Well, have you or has any other member of the staff of the company ever undertaken to ascertain the complete facts with respect to this transaction?

A. There was no occasion for us to make such an ascertainment, Mr. Gorman.

Q. Well, I merely inquired whether or not there had been such an investigation made.

A. I can only speak for myself. The answer is "No."

Q. Then, in so far as you know with respect to others, do you know whether they have made any such study?

A. I am of the opinion that somewhere among the many discussions that may have taken place between myself and others connected with Panhandle Eastern Pipe Line Company during the past ten years that I have had some statements made to me that some one of those individuals, however many or few there may have been, tried to learn more about these two items than were shown by the cold facts and figures in the books and records.

Q. You do not know who that person might have been or what the result of such a search may have produced?

A. I am afraid you are asking me to draw entirely too much on my memory to state positively whether there was even such a circumstance, although I seem to remember [fol. 7123] that we just did not pass it over lightly. Our custom is not to do that. We have had so many occasions upon which we have diligently sought to know a little bit more about the gas sales and purchase contracts than the records would show us, that we must have pursued and exhausted all reasonable courses and avenues open to us to learn something more about it.

Q. You refer to a note in the amount of \$136,000. Was that a similar transaction whereby the company purchased 4,000 shares of common stock of Missouri-Kansas Pipe Line Company, also from Frank P. Parish & Company, and for similar reasons?

A. It was for similar reasons. The transactions may not have been exactly similar due to the fact that it appears that there was no specific action taken by the Board of Directors with respect to the latter amount. There may have been some informal discussions at some meeting of the Board. My memory at the moment is, however, that it was not authorized by the Board in the same manner as the purchase of the 15,000 shares represented by the \$420,000 item.

Q. You are, of course, familiar with the statements contained in the report of Mr. Steele of the Federal Trade Commission to the effect that the majority of these 19,000 shares of stock we have been discussing were distributed to [fol. 7124] Frank P. Parish and to W. G. McGuire, are you not?

A. I observe that Mr. Steele states that on page No. 41. I heard of such a distribution before. I have, also, heard—and this is pure hearsay—that there may have been

some difference between those two gentlemen as to who got what and why.

Q. Yes, but you, I assume, according to your previous testimony, know no facts with respect to this distribution?

A. I do not, and from the standpoint of the controversies that I seem to remember I am rather grateful of that fact.

Q. Mr. Parish, according to your knowledge, was president of the Missouri-Kansas Pipe Line Company, and also president of the Panhandle Eastern Pipe Line Company and, also president of the Frank P. Parish & Company in 1930, at the time of these transactions?

A. I have no knowledge, whatever, of Frank P. Parish & Company other than of the nature of one who had acquired such knowledge by hearsay, newspapers, or otherwise. I do not recall at this moment of having any knowledge whatever, specifically, of the officers of Frank P. Parish & Company.

I would assume, however, that the name would indicate [fol. 7125] something and it may have been possible that Mr. Parish was president of the company.

As to Missouri-Kansas, I do not believe there is any question, is there, that Mr. Parish was not the president of that company and, certainly, there cannot be any question that Mr. Parish was not president at one time of Panhandle Eastern Pipe Line Company. Whether all of those facts were coincident is something, sir, I believe you will have to supply me with.

Q. Can you tell us, Mr. Watkins, whether the records of your company show that as of May 23, 1930, or some date prior thereto, the Panhandle Eastern Pipe Line Company had actually entered into contracts with the Illinois Power & Light Corporation and the Missouri Power & Light Company for the sale by Panhandle and the purchase by the other companies of natural gas?

Mr. Wheat: What companies were those?

Mr. Gorman: Illinois Power & Light and Missouri Power & Light. Those are the two companies which were referred to in the minute of the Board of Directors, May 23, 1930, which has been read into the record?

The Witness: Mr. Gotman, if I may, I would like to answer your question this way: I recall very vividly at the time I first became connected with Panhandle Eastern Pipe Line Company, which was the 17th day of November, [fol. 7126] 1931, that the company did have contracts with Missouri Power & Light Company and with the Illinois Power & Light Company. Without refreshing my memory by reference to our documental files, I should say that Panhandle Eastern Pipe Line Company or Panhandle Illinois Pipe Line Company, a subsidiary since dissolved, both or either actually made deliveries to those companies under such contracts and have continued to make deliveries continuously thereafter, either under the original contracts and some amendment thereof, some extension thereof, some renewal thereof, or some rate schedule, which companies were required to or found it necessary to file either with the Public Service Commission of the State of Missouri, or with the Illinois Commerce Commission.

The total sales to Missouri Power & Light Company from September 1, 1930, to December 31, 1941, arising either from contracts acquired by Panhandle Eastern and subsidiary companies directly or through Missouri-Kansas Pipe Line Company amounted to \$3,742,445 and to Illinois Power & Light Company, the successor company—correction, please, the name of which has since been changed to Illinois-Iowa Power Company—on May 1, 1937, the sales were \$3,385,922.92 for the same period. During that period Panhandle Eastern or Illinois Natural Gas Company, likewise, sold the Keystone Steel & Wire Company \$2,373. [fol. 7127] 964.46, the Caterpillar Tractor Company, \$285,076.94, and the R. Herschel Manufacturing Company \$41,799.13, or a total of these five organizations of \$9,829,208.45.

Q. Are you finished? A. I believe I am, sir.

Q. Despite the length and breadth of your answer, I do not believe you have answered my question.

Will you read that back?

(Question read as follows: "Can you tell us, Mr. Watkins, whether the records of your company show that as of May 23, 1930, or some date prior thereto, the Panhandle Eastern Pipe Line Company had actually entered into contracts with the Illinois Power & Light Corporation and

the Missouri Power & Light Company for the sale by Panhandle and the purchase by the other companies of natural gas?")

By Mr. Gorman:

Q. Do you understand my question, Mr. Watkins?

A. Pardon me, I was trying to find something so that I could answer your question definitely. May I have the opportunity to continue my search?

Q. Yes, indeed. A. Now, may I have the question?

(Question re-read.)

[fol. 7128] The Witness: I am quite positive Panhandle Eastern had entered into such contracts. If you care to have me do so, I shall obtain the dates upon which the contracts, if there be any, came into existence, whether it be prior to May 23, 1930, or subsequent thereto. One of the reasons why I am positive there were such contracts as that when I appeared on the scene in 1931 Panhandle Eastern was involved in a proceeding of some sort before the Illinois Commerce Commission or, rather, I should say, Panhandle Illinois Pipe Line Company was involved as a result of some of the contracts for the sale of gas for distribution in the State of Illinois. I remember that quite distinctly.

[fol. 7129] Q. Had you completed your answer?

A. I believe so, yes, sir.

Q. Was that controversy, to which you are now referring, one involving a proposal of certain towns in Illinois to change over from manufactured to natural gas, which was a proceeding before the Illinois Commerce Commission?

A. It was before the Illinois Commerce Commission. There were change-over requirements involved, the exact file or docket number I could not supply.

Q. And it is your present recollection that the contracts were enter into with these companies before such controversy arose?

A. Yes, it is.

Q. Well you please undertake, Mr. Watkins, to furnish us with the dates of the first contracts with these companies or their subsidiaries if the sales were actually made to subsidiary companies and if you are able to do so furnish

us with at least one copy of such contracts? I might state if it should perchance happen that any of these contracts had been previously filed with the Federal Power Commission, if you will just refer us to the title thereof, we shall endeavor to locate it in the files of the Commission without your furnishing it.

A. I should be very glad to do that, sir.

Q. Now, in the course of a statement a few minutes [fol. 7130] ago in response to the previous question, you referred to certain sales, both in volume, I believe, and dollar value, to certain companies other than the Illinois Power & Light Company and the Missouri Power & Light Company.

A. That is correct, except there was no reference to volume.

Q. Yes. Well, were those other companies to which you made reference subsidiaries of either the Illinois corporation and the Missouri company?

A. I believe they were not.

Q. Well, what was the purport of your statement with respect to sales made to these other companies?

A. If you will recall, this morning reference was made to those five companies in previous testimony and while having the memorandum in front of me at the time I was giving you the data with respect to Missouri Power & Light and Illinois Power & Light, I simply volunteered the remaining information.

Q. Well, now, were those sales made pursuant to contracts which were acquired from the Missouri-Kansas Pipe Line Company?

A. Either pursuant to such contracts, renewals, amendments thereof, modifications, or whatever you do with a contract or rate schedule that subsequently replaces the contract, there were sales, the origin of which can very [fol. 7131] definitely be traced back to the right Panhandle-Eastern acquired from Missouri-Kansas Pipe Line Company by virtue of certain of the assets, constituting a part of the \$19,300,000 donated September 17, 1930.

Q. But they were not related to the—

A. (Interposing) Two items of \$420,000 and \$136,000, no.

Q. Now, were these contracts which we have just been discussing purported justification for the payments in 1930 to the American Coke & Chemical Contracting Company of \$75,000 for securing such contracts?

A. If I understand your question correctly, sir—

Q. (interposing) Let me put it this way.

A. If you will pardon me, please.

Q. Yes, indeed.

A. If I understand your question correctly, sir, and I am rather careful with Panhandle Eastern Pipe Line Company's money, there could be no hesitancy whatever on my part of recommending an expenditure of \$75,000 which would produce over the period from September 1, 1930 to December 31, 1940 sales from Keystone Steel & Wire Company and Caterpillar Tractor Company and the R. Herschel Manufacturing Company, aggregating, respectively, \$2,373,964.56, \$285,076.94 and \$41,799.13.

[fol. 7132] Q. Now, were these contracts which we have just been discussing purported justification for the payments in 1930 to the American Coke & Chemical Contracting Company of \$75,000 for securing such contracts?

The Witness: There is slight confusion in the witness' mind, Mr. Gorman, whether or not your question was directed to the \$420,000 and the \$136,000 items, or whether it was directed to the \$75,000 item, because the companies involved in the first two of those items were different from [fol. 7133] the companies that you mentioned with respect to the \$75,000.

By Mr. Gorman:

Q. Let us put it this way, Mr. Watkins, and I think we can dispose of it more readily. Do the books of the Panhandle Eastern Pipe Line Company show a payment of \$75,000 to the American Coke & Chemical Contracting Company as payment for their services for securing certain gas contracts?

A. They do, and that facts was fully testified to by this witness this morning.

Q. Yes. And those contracts, in which the American Coke & Chemical Contracting Company was purported

to have rendered assistance in the acquisition of, were contracts with the Keystone Steel & Wire Company, the Peoria Malleable Castings Company, the Caterpillar Tractor Company and R. Herschel Manufacturing Company, all of Peoria, Illinois. Is that correct?

A. I do not know whether all of the companies were of Peoria, Illinois, or not. I will accept your statement as to that. Otherwise, it is correct and the amounts that I have previously testified are the amounts that we received from such sales for the period from September 1, 1930 to December 31, 1940.

Q. Thank you.

[fol. 7134] Q. Mr. Watkins, at the time of the recess we had just mentioned certain payments to the American Coke & Chemical Contracting Company for its assistance in securing gas sales contracts with the Keystone Steel & Wire Company, Peoria Malleable Castings Company, the Caterpillar Tractor Company and the R. Herschel Manufacturing Company.

Did the Panhandle Eastern Pipe Line Company subsequently enter into contracts or a contract with the Peoria Malleable Castings Company?

A. I do not know.

Q. I believe you have mentioned sales figures concerning sales made under contract to the other companies I have just mentioned, have you not?

A. I have.

Q. Do you know, or do your notes show the date of such contracts with these companies?

A. They do not and, as the witness has tried to explain throughout the testimony today, it may very well be that if there were contracts with the companies to which counsel refers at or about the date of payment to American Coke & Chemical Contracting Company that subsequent deliveries were made in pursuance to such contracts, per se. [fol. 7135] There may have been changes brought about by reason of differences and circumstances or conditions or requirements of the Illinois Commerce Commission, but, nevertheless, sales were made to those companies and came about by reason of the activity of the company to whom

the payment of \$75,000 was made, not wholly because of the activity of that company but through the assistance it rendered.

Q. Can you state, generally, what assistance was given by the American Company in securing these contracts? First, let me ask you this, whether or not you know if any of these companies which subsequently became purchasers of the Panhandle Company, were subsidiaries or affiliates of the American Coke & Chemical Contracting Company?

A. I do not.

Q. Do you know what assistance it did give in securing contracts from these companies?

A. I would simply assume, Mr. Gorman, that it must have given some substantial assistance, otherwise the payment of \$75,000 would not have been made. Actually the exact assistance rendered is something about which I know nothing.

Q. Now, will you undertake, Mr. Watkins, to obtain for us the dates upon which the Panhandle Eastern Pipe Line Company entered into contracts with the Keystone Steel & Wire Company, the Caterpillar Tractor Company and the R. Herschel Manufacturing Company, and also, furnish [fol. 7136] us with copies of such original contracts?

A. I will undertake so to do. May I state, however, that we have throughout the afternoon been referring to Panhandle Eastern and contracts with certain organizations, some of which may be in the State of Illinois? Those contracts may have not been between Panhandle Eastern and the purchasing company. The sale may have been through a subsidiary of Panhandle Eastern. The contract may have been with a subsidiary of Panhandle Eastern or the contracts may have been with the purchasing company whether it was a distributing organization or an industrial user and Missouri-Kansas Pipe Line Company, so that when we speak broadly of Panhandle Eastern it is a witness' assumption that we are talking about the original contract with whomever it may have been, although it came to Panhandle Eastern by right of succession, if that is a proper way to put it.

Do we understand each other?

Q. Yes, that may be so understood. Of course, it is my understanding, also, that since these amounts are set up on the books of the Panhandle Eastern Pipe Line Company itself, it would be some subsidiary other than the Illinois Natural Gas Company. Is that correct?

A. Illinois Natural Gas Company did not come into existence until the early part of 1938, I believe.

Q. So that these contracts could not, in any way, affect that subsidiary of the Panhandle Company?

A. Oh, yes, they could.

Q. You mean as of delivery?

A. The effect of the delivery subsequent to the time Illinois Natural acquired the properties of Panhandle Illinois Pipe Line Company is a most vital part of Illinois Natural's affairs.

[fol. 7138] Q. Well, now, let us see if we can understand one another a little more. Do you recall approximately when the Panhandle Illinois Company was organized?

A. August 16, 1930, and it was dissolved July 30, 1938. Illinois Natural Gas Company was organized January 19, 1938, and has not yet been dissolved.

Q. Now, any contracts and any payments made in connection therewith, to which the Illinois Natural Gas Company has succeeded to the rights of the Panhandle Illinois Company, would be reflected on the books of those two companies, would they not?

A. That is correct, however, I do not believe there were any charged on the books of either of those companies of the character that Panhandle Eastern carries in its gas sales and purchase contracts. The \$75,000 item, concerning which we have been discussing, was registered on the books of Panhandle Eastern Pipe Line Company, although the benefit flowed directly to a subsidiary.

Q. Yes.

A. The reason for that, sir, if I may supply it, if you want it, is due to the fact that originally it was intended that Panhandle Eastern would have all the facilities from the producing fields to its present terminus at or on the Illinois-Indiana State line. There were reasons when the construction work was undertaken that made it necessary [fol. 7139] to bring about the corporate existence of a subsidiary to own and operate the properties and facilities

located within the State of Illinois. Subsequent to those requirements, it has been possible for Panhandle Eastern Pipe Line Company to acquire the main transmission system in the State of Illinois represented by the line the witness is pointing to on Exhibit 15 placed here on the wall at the hearing room.

At that time, which was as of June 30, 1938, I believe, Illinois Natural Gas Company acquired the lateral lines used to serve the customers in the State of Illinois. A recent decision of the Supreme Court may make it possible for Panhandle Eastern to acquire, through the dissolution of Illinois Natural Gas Company, all of the facilities that that subsidiary owns in the State of Illinois.

Now, we are dealing with a consolidated picture here, so that if we inadvertently speak of Panhandle Eastern having made disbursements with respect to something that Panhandle Illinois, or Illinois Natural, or any of its other subsidiaries received the benefit of, it does not change the consolidated picture, so far as the whole is concerned. Perhaps we should not worry ourselves about being too precise.

Mr. Cylton: Panhandle Illinois was a 100 per cent subsidiary of Panhandle Eastern?

[fol. 7140] The Witness: It was, sir, and the date of its incorporation and the date of its dissolution, as well as the date of incorporation of Illinois Natural, is shown on page 1 of Exhibit No. 112 in this proceeding.

Mr. Cylton: And Illinois Natural, likewise, is a 100 per cent subsidiary?

The Witness: That is correct, sir.

Mr. Cylton: Pardon me for interrupting, but I wanted that to appear.

Mr. Gorman: Yes.

By Mr. Gorman:

Q. As a point of clarification, only, Mr. Watkins, as a matter of fact, the entire amount which has been set up as representing amounts allocable to gas sales and purchase contracts has been contained solely in the books of

the Panhandle Eastern Pipe Line Company, has it not, despite the fact that such contracts may have been in the past or possibly even in the present made with a subsidiary of the company?

A. I believe that is quite true. There may, however, be this situation, Mr. Gorman:

If you recall during the morning session the witness testified that there were certain office payroll general expenses, attorney fees, and so forth, aggregating some \$12,000-odd that formed a part of the \$3,053,391.53, to [fol. 7141] which some reference was made this morning, that may have come into existence in one of the subsidiaries, but it found its way into the Panhandle Eastern Pipe Line Company's records, and I do not recall at this moment of any items that now are reflected in records or books of account of Illinois Natural Gas Company of that nature.

Q. Now, I believe you have previously referred to an item entered on the books of the company under this account in the amount of \$1,000, which, as I recall your testimony, was a premium paid for a contract bond in connection with the gas sales contract with the Keystone Steel & Wire Company.

A. I have.

Q. And that, I assume, represents wholly and entirely the actual premium paid on such bond. Is that correct?

A. It does.

Q. Now, do you, also, have an entry on your books in the amount of \$9,500 representing payment to agents for fees and expenses in connection with obtaining gas sales contracts?

A. We do.

Q. Can you tell us, generally, what that item represents?

A. That payment was likewise, made to American [fol. 7142] Coke & Chemical Contracting Company for engineering fees and/or expenses incurred by that company in connection with the procurement of gas sales contracts with Keystone Steel & Wire Company, Peoria Malleable Castings Company, Caterpillar Tractor Company, and R. Herschel Manufacturing Company.

Q. In other words, that was for the same purposes that the \$75,000, to which we have previously made reference, was paid?

A. Yes, that is correct, except that in the one instance one apparently was in discharge of an obligation for services rendered while the smaller amount or \$9,500 was for expenses incurred in connection with the rendition of such services.

Q. And is there, also, an entry on the books of the Panhandle Eastern Pipe Line Company in the amount of \$786.30?

A. As a matter of fact, there are three entries making up the total of \$786.30, all of which were in settlement of traveling or other expenses incurred by Mr. Frank P. Parish.

Q. And those, I correctly assume, do I not, represent actual moneys expended for such purposes?

A. As far as I know, they do.

Q. Now, all of the items we have heretofore discussed [fol. 7143] in detail were entered on the books of the company prior to December 31, 1930, were they not?

A. Well, we have discussed a lot of items, Mr. Gorman.

Q. Well, shall I sum it up this way, the item of \$556,000 the item of \$75,000, the item of \$1,000, the item of \$9,500, the item of \$786.30 and the item of \$2,398,402.19—

A. (Interposing) Were entered on the books of Panhandle Eastern Pipe Line Company prior to what date, sir?

Q. December 31, 1930.

A. That is correct.

Q. And do you, also, have an entry some time during the year 1931, in the amount of \$11,142.12?

A. There were several entries made during the year of 1931 and 1932, the total of which is \$12,703.04.

Q. Yes. Were those all made for the same purpose?

A. The same general purpose.

Q. Yes.

A. Not with respect to the procurement of any of the contracts we have specifically referred to.

Q. And what were those payments for in a general way?

A. Well, they were in connection with the procurement [fol. 7144] of any contracts, gas sales or gas purchases contracts procured during that interval by such of the

company's employees whose salaries and expenses were at that time allotted to this particular work and it consisted, generally, as we have heretofore stated, of payroll, traveling expenses and a very small item I observe here of attorney fees.

Q. And with the exception of the attorney's fee, a small item which you mentioned just now, those are what might be termed generally promotional expenses incurred by members of the staff?

A. I think that is correct. Now, in connection with that, I should like to call attention, again, to this fact, that is, as you know, prior to March 31, 1932, although we maintained records with respect to income and expenses, the result of the maintenance of those records is now reflected in the Gas Plant Accounts for the reason that as of March 31, 1932, any net income or net losses were capitalized.

We understand that, do we not?

Q. Yes. Now, the total of all of these items represents, does it not, the aggregate of \$3,053,391.53, which is shown under various columns on Line 40 of page 2 of Exhibit No. 52?

A. It does.

Q. And, as you have previously indicated, there was [fol. 7145] debited to this reserve in 1936, an amount of \$123,105.13 representing the application of reserves accumulated against this account as of that date?

A. Not debited to it, Mr. Gorman, but credited to it.

Q. I beg your pardon.

A. It was applied to the total. That is the substance of what we are getting at here.

Q. And that, of course, resulted in the total of \$2,930,286.40, which is shown at Line 40 of Exhibit No. 52, page 2, in Column M, and the succeeding columns shown thereon?

A. If the reduction of the amount \$3,053,391.53 by the \$123,000-odd item leaves that figure, yes.

Q. Now, all of these expenses and charges, other charges, are related, are they not, to those contracts only which are said to have been acquired from the Missouri-Kansas Pipe Line Company as of August 31, 1930?

A. At the origin of the account they were related to such contracts. I have tried to explain during the course

of the testimony today that the contracts we may have received at the time the account originated may not be the exact instrument.

Q. Yes, it may have been modified or changed or revised wholly?

[fol. 7146] A. Or service may now be being rendered under a rate schedule.

Q. Yes.

A. With that explanation, the answer to your question is yes.

Q. Now, these items have no relation whatsoever to the amount of \$553,992.48, which is shown at page 966 of Exhibit No. 39 for identification, and at page 3 of Exhibit 153, for identification, do they?

A. Mr. German, I am afraid that I cannot make too definite statements with respect to page 966 of Exhibit No. 39, because I am not responsible for that exhibit. The total shown there in one instance of \$553,992.48 apparently represents the same items that are a part and parcel of the three pages of Exhibit No. 153.

Q. Yes. Of course, an examination and comparison will readily disclose that, but in your examination of this morning, and I assume you have previously examined page 966 of Exhibit No. 39, it is your impression, is it not, that they do represent the same items?

A. To the extent that the amounts are the same, that is, the total amounts are the same, I think that is quite proper.

[fol. 7147] Q. By that you mean the aggregate total as distinguished from the individual payments to the several utility companies?

A. Not necessarily, no. My remembrance goes to the fact that page 966 of Exhibit 39 has some \$5,000,000 odd.

Q. Well, I am speaking now only of the total and components of such total which are shown at line 30 and the lines above line 30 on page 966 of Exhibit 39.

A. With that correction, sir, they are identical.

Q. Now, will you please refer to Exhibit 153, which is entitled "A Statement of Cost of Business Development, Period from April 1, 1932 to June 30, 1941," particularly to lines 1, 2, and 3 on page 1 of this exhibit?

A. I am ready, sir.

Q. I note that as of August 7, 1936 a cash payment of \$87,500 was made to one Frank P. Parish and on the same date a cash payment of \$12,500 was made to one Dupuy G. Warrick. Are you familiar with the circumstances which led to such payments?

A. I am.

Q. Will you, for the purposes of the record, give us in some detail the circumstances which led to the payments which I have just mentioned?

A. On or about June 20, 1935, Mr. Frank T. Parish [fol. 7148] came to the company and stated that he had been in Detroit with his lawyer for a considerable time, that he was satisfied he could obtain the contract for the supply of Panhandle gas to the City of Detroit, that it was expensive for him and his lawyer to travel back and forth to Detroit, and live there, and asked if the company would be willing to pay this expense. He was told that the company would give him \$1,000 a month for four months and at the end of that time if the situation did not warrant, after a review, the company's feeling that sufficient progress has been made to justify a continuance of the advances, that such advances would cease.

On or about October 15, 1935, the Directors of Panhandle Eastern in an informal discussion decided to continue the arrangements made with Mr. Parish on or about June 20, 1935, temporarily, at the discretion of the officers. After a contract had been obtained with the Detroit City Gas Company,—and there is no question I presume that we are referring to what is now known as Michigan Consolidated Gas Company,—Mr. Parish rendered an expense statement for himself and his attorney in the aggregate amount of \$12,769.92, which Panhandle Eastern Pipe Line Company paid.

At a board meeting held July 14, 1936, Panhandle Eastern Pipe Line Company acted upon a claim for compensation by Messrs. Parrish and Warrick in connection [fol. 7149] with the contract with Detroit City Gas Company dated August 31, 1935 and payments of such compensation aggregating \$100,000 were made to Mr. Parish for his part in the amount of \$87,500 and to Mr. Warrick for \$12,500.

If you wish to be very precise about the payments of the \$87,500 made to Mr. Parish, \$50,000 was made for his account to Michigan Gas Transmission Corporation, I believe, who had previously advanced such an amount to Mr. Parish and to whom Mr. Parish assigned \$50,000 of the amount awarded him by Panhandle Eastern Pipe Line Company.

What gave rise to the distribution between Parish and Warrick of the amount, the total of \$100,000 paid by Panhandle Eastern is something this witness has no knowledge of. A purely gratuitous observation on the part of this witness, however, is that if Mr. Parish and Mr. Warrick rendered any service whatever in connection with the procurement of the contract with the Detroit City Gas Company, the amount they received from Panhandle Eastern Pipe Line Company was certainly quite modest.

Q. Mr. Warrick was attorney for Mr. Parish, was he not?

A. In this particular instance he was. Whether he was Mr. Parish's—

Q. (Interposing) Well, I meant in this instance.

A. Correct.

Q. And, of course, that would explain any payment [fol. 7150] which was made to Mr. Warrick by Mr. Parish or directly by the company, itself?

A. I think it should, yes.

Q. Now, at the meeting of July 14, 1936 of the Board of Directors of the Panhandle Company at which this compensation was decided upon, the Board had before it, did it not, a letter dated July 6, 1936 from Messrs. Parish and Warrick giving an outline of the services they claim to have rendered in procuring the Detroit gas contract?

A. It did.

Q. Will you undertake, Mr. Watkins, to furnish to me, please, a copy of such letter of July 6, 1936?

A. If I must.

Q. Was Mr. Parish at this time connected with the Panhandle Eastern Pipe Line Company in the capacity of an officer or director of that company?

A. He was not.

Q. Do you know when his severance with the company had been made?

A. Mr. Parish ceased to be president of Panhandle Eastern Pipe Line Company on October 23, 1930 and was replaced by Mr. F. W. Crawford, who became president on that date.

Q. Was that his last official connection with the company, either as an officer or as a director?

A. Mr. Parish continued to be a director of Panhandle [fol. 7151] Eastern Pipe Line Company until the annual meeting of the stockholders of the company held March 14, 1932, at which time he was replaced by Mr. J. H. Hillman, Jr. Slightly prior to that date or about that date, Missouri-Kansas Pipe Line Company found itself in receivership.

Q. Now, all of the other payments shown on this Exhibit No. 153 were in the nature of contributions to public utility companies for expenses incurred with change-over to natural gas or promotion of the sale of natural gas in the communities served by the various utilities, were they not?

A. Before I answer that question, Mr. Gorman, may I go back for a moment to make this observation with respect to the dates upon which Mr. Parish ceased to be an officer or a director and the dates upon which his successors were chosen?

Q. Yes, indeed.

A. And state that the tabulation from which my answers were given speak as of the date the change became effective. It may have been possible, for instance, that Mr. Parish had a resignation pending prior to the date upon which he ceased to be either president or a director.

Now, as to the other payments, Exhibit No. 153, they do represent payments made to distributing organizations or to organizations purchasing gas from Panhandle Eastern Pipe Line Company for resale or to organizations delivering gas on Panhandle Eastern Pipe Line Company's account to some distributing organization.

[fol. 7152] The purpose, I believe, is shown, generally, in Exhibit 153 as to each such payment.

Q. Yes.

A. In characterizing the amounts on Exhibit 153 as payments, it would be well for us to remember that the

totals in several instances are the results of more than one payment. For instance, the \$94,000 on line 18, page 1, of Exhibit No. 153 represents three amounts.

Mr. Wheat: Well, Mr. Watkins, as shown in Column F of Exhibit 153, is it not?

The Witness: That is correct.

By Mr. Gorman:

Q. So that the general facts are more or less generally set forth on this Exhibit 153?

A. I believe they are quite fully set forth.

Q. Now, amortization is provided and has in the past been provided, has it not, for this total [mount] of \$553,992.48, which is shown in Column E, line 36, page 3, of Exhibit 153?

A. Not for the entire amount, because as you recall—

Q. (interposing) Well, by that I mean the entire amount is presently being amortized, is it not?

A. The residue?—

Q. That is right.

A. Of the original amount is. You recall that you directed the witness' attention this morning to certain items that have been charged in the first instance to business promotion expense.

Q. Yes, excepting the \$30,000 odd which we have previously discussed.

A. Your statement is correct, sir.

Q. Is the accrual for amortization provided in a specified manner, as is the annual accrual with respect to the gas sales in certain contracts as distinguished from this account of "Other Gas Sales and Purchase Contracts"?

A. These items are a part and parcel of the amounts registered as charges to other gas sales and purchase contracts.

Q. Yes, but as I understand the testimony you have previously given, you are required by a certain amendment to your certificate of incorporation to set aside each month a certain specified amount to amortize the amount shown on line 40 at page 2 of Exhibit No. 52, as representing the account for gas sales and purchase contracts. Is that correct?

A. That is correct.

Q. My inquiry presently is whether or not you have such a specific provision for amortization in the amounts shown at lines 43 and 44 on page 2 of Exhibit No. 52 for account entitled "Other Gas Sales and Purchase Contracts."

[fol. 7154] A. In the certificate of incorporation or elsewhere?

Q. Elsewhere.

A. No.

As the witness has previously testified, our procedure with respect to these amounts is to amortize them through gross income over the life of the contract or based on units of sales, as the case may be, and the amount is determined by the conditions present in each of the contracts, in connection with which the expenditures comprising the original total of which the amount \$365,334.99 shown on line 44 in column M on page 2 of Exhibit No. 52 represents.

Q. Well, where you are making sales pursuant to a contract which has a certain specified term, do you provide amortization on a straight line basis over the term of the contract?

A. We do. Would you like an instance.

Q. I would appreciate one.

A. With your concurrence, we shall refer to certain of the items shown in detail on Exhibit No. 153, making up a total of \$371,076 which have to do with the procurement of our contract with Detroit City Gas Company, now Michigan Consolidated Gas Company. At September 30, 1941, according to our determination, that contract had 123 months to run and the amount of amortization set aside with respect to the \$371,076 on a straight line basis for the month of September, 1941 was \$2,046.53.

[fol. 7155] Q. That represents, does it, 1-123 of the remaining balance which had not been amortized?

A. In this particular case, I believe it would represent the result of dividing the \$371,076 by the total number of months the contract period originally covered.

To amortize it on the basis of 1-123 for the month of September and 1-122 for the month of October might not give exactly that same result.

Q. And in such cases, I assume that you have been providing such amortization since the time that charges were made as shown on Exhibit No. 153?

A. That has been our general practice, yes.

Q. And as you have indicated, on a monthly basis in all cases?

A. Not in all cases. Some of the amortization, in prior periods, may have been based on units of gas sold. The particular treatment depended upon the terms of the contract or the conditions or provisions of the particular contract in connection with which such expenditures had been incurred.

Q. Under what circumstances would you provide for an amortization on the basis of units of gas sold?

A. If we acquired a contract from a distributing organization or from an industry for that matter, and there were [fol. 7156] costs in connection with the acquiring of such contract a portion of which might be returnable to the company if the sales under the contract did not aggregate either certain annual figures or certain amounts in volume over the life of the contract, it would be necessary and proper, we believed and still believe, to base such amortization on units of volume.

Q. Is the company at the present time providing amortization accruals on both bases?

A. I do not believe we have at this time any amounts subject to such amortization that require months amounts determined on the basis of volume.

Q. So that in so far, conversely speaking, as you are presently aware, all amortization accruals are based upon the contract terms?

A. That is correct.

Q. From time to time, Mr. Watkins, you have referred to sales made under rate schedules and, apparently, in such references, distinguish them from sales made pursuant to contracts.

Does the Panhandle Company presently make sales pursuant to open schedules, that is, schedules available to any customer along its line?

A. If so, such contracts are a part of the files of this Commission. If you would not bind me too closely to an [fol. 7157] answer, I will give you the best of my remembrance at the moment.

Q. You may do so, if you will.

A. All or virtually all of the sales made in the State of Illinois for the past several years have been made under rate schedules. At the time of the adoption of such rate schedules, there may have been some contracts in existence and there still may be some peculiar contracts in existence dealing with or having to do with, rather, with industrial sales.

Most recently, Panhandle Eastern adopted rate schedules for the States of Missouri and Kansas and, more recently, for the State of Indiana. And you may recall some delay the company has experienced with the Indiana sales subsequent to August 1, 1941, so that my statement may be imperfect in certain directions with regard to those sales.

Q. Yes.

A. Now, in the filing of the rate schedules for the States of Missouri and Illinois and, I believe, in Indiana, our effort has been to preserve—and here I may be dealing with legal phraseology concerning which my knowledge is somewhat limited—the right Panhandle Eastern has to require any of the organizations it may have been selling gas to under contracts before the rate schedules were filed throughout the natural life of such contracts. Is that understandable?

[fol. 7458] Q. Yes, it is.

May it be properly concluded, therefore, Mr. Watkins, that all of the gas sales contracts which are being presently amortized, represent what you have designated as contracts as distinguished from the rate schedules that you have just been discussing?

A. I think that is proper to state if we connect it with the time at which the disbursements were made.

Q. Yes. I, of course, am not referring at all or considering in any way the fact that most, if indeed not all, of these several contracts have been filed with the Federal Power Commission as rate schedules. You so understood, I believe?

A. I believe I understand that, although I should like to state, without quibbling over minutiae, there may

be some industrial contracts in some of the exhibits presented in these proceedings which Panhandle Eastern does not necessarily, of itself, consider that it has filed. It has furnished, pursuant to certain orders, certain contracts which it, Panhandle Eastern, does not necessarily feel must be filed formally with the Commission.

Mr. Culton: You had reference to gas for resale?

Mr. Gorman: Yes. I think we understand one another. I merely wanted to distinguish between what we consider [fol. 7159] as rate schedules under the Natural Gas Act as distinguished from those which Mr. Watkins has been designating here as contracts.

By Mr. Gorman:

Q. Mr. Watkins, I invite your attention to Lines 19 to 35, Page 3, of Exhibit No. 153, at Line 23, Column B.

There is set forth a total amount of \$33,130 which is explained on the Lines 19 to 23, inclusive. Is this amount of \$33,130 the same amount which we have previously been discussing as having been charged as an operating expense rather than to the gas plant account?

A. It is.

Q. And with the exception of that \$33,130, has the remaining balance of the total of \$553,992.48 been expended in connection with sales made east and north of the termination point of the line of the Panhandle Eastern Pipe Line Company at Dana?

A. You would not be wanting to cause me to state definitely where change of title took place, would you?

[fol. 7160] Q. I do not quite understand your question, Mr. Watkins.

A. Michigan Gas Transmission Corporation transports certain gas for Panhandle Eastern Pipe Line Company—

Q. (Interposing) I am merely speaking now of geographical location as distinguished from the actual seller.

Mr. Culton: That was the question, east of Dana.

Mr. Gorman: Yes, that is right.

The Witness: I shall state that it represents disbursements made in connection with sales, either east or east and north of the termination of Panhandle Eastern Pipe Line Company's facilities at or near Dana.

By Mr. Gorman:

Q. Yes, and do the amounts shown on Page 2 of Exhibit No. 52 at Line 40 for gas sales and purchase contracts represent contracts in what has been generally described in this proceeding as the Local Area?

A. What line, sir?

Q. Line 40.

A. No, it would not be proper to say that. The Local Area, as it has been generally defined in this case, would not, according to my remembrance of such definition here, include sales made, for instance, in the State of Illinois [fol. 7161] and as you will recall, some portion of the \$2,930,286.40 shown on Line 40 was in connection with sales to be made or being made in that State.

Now, we must examine the constituent parts of the \$2,930,286.40 somewhat more than could be done by your statement, your question, before arriving at an answer and give consideration to the difference between the amount at which this item or the items represented by this amount as carried on the books of Missouri-Kansas Pipe Line Company and as recorded on the books of Panhandle Eastern Pipe Line Company before we dispose of the question.

Said differently, it would seem that there was in the mind of someone the rights either to buy gas or to sell gas somewhere other than perhaps such rights represented by the actual instruments received from Missouri-Kansas Pipe Line Co. any, without cost, by Panhandle Eastern when the amount at which the items were recorded on the books of Panhandle Eastern was determined.

It is correct to state that a considerable portion of the gas purchase contracts represented the right to purchase gas in the so-called Local Area.

Q. Were there any gas purchase contracts in any other than the Local Area territory?

A. There were some purchase contracts, Mr. Gorman, representing the right to buy gas in either the Panhandle

[fol. 7162] of Texas or in the Hugoton Field in the company's possession at or about this time or in the possession of one of its subsidiaries.

Whether the difference assigned to this particular account represented any of such contracts, I am not in position to state.

I have the feeling, however, that this difference must have represented some substantial right in the minds of the people making the entry and, likewise, in the minds of the Board of Directors when, at its meeting held in February, 1931, I believe, it ratified, approved and confirmed the action theretofore taken in recording the amounts.

Does that seem confusing to you?

Q. Well, I do not quite understand all of it. I was just turning over in my mind the hope that when I see it on the record, it might be more understandable.

A. Thank you, sir.

Q. May I summarize a portion of your statement and ask you whether or not it is to the effect that such obligations or contracts as the Missouri-Kansas Pipe Line Company may have contracted for and which rights were subsequently transferred to the Panhandle Eastern Pipe Line Company as of August 31, 1930, represented not only certain contracts which the Missouri-Kansas Pipe Line Company, as an operating utility, had been performing prior to such transfer and for which it had such facilities [fol. 7163] as would enable it to perform such contracts but also represented other rights or other contracts which, by a subsequent construction, it hoped to be able to fulfill?

A. Well, we have our facts slightly awry there, Mr. Gorman.

First, I would not characterize Missouri-Kansas Pipe Line Company as a utility.

Q. I was speaking of such of its activities as would be classified as a public utility.

A. Second, not all of the facilities were constructed at September 30, 1930, or, rather, September 1, 1930, and, finally, it was not the witness' intention to leave the im-

pression that it was his view that in recording the gas sales and purchase contracts of [of] September 1, 1930, there was, in the minds of the people making the entries or in the minds of the Board of Directors when ratifying such action later in the early part of 1931, an effort to assign any amount on the books of the company representing any contracts that might later be acquired.

The statement or rather the answer that I gave that may have been confusing to you ran to the feeling in my mind that there was some very good reason, unquestionably, for the difference between either amount you choose to use of the \$926,250 or the \$1,106,250 and the \$2,930,286.40, all of [fol. 7164] which we have discussed at quite some length today and I must state again that, looking at this action in retrospect, it does seem to this witness that the amount was totally inadequate.

Q. Yes, but it has also seemed to be your testimony, I believe, that any amount attributable or set upon the books of the Panhandle Eastern Pipe Line Company was supposed to be related in its entirety to contracts which were in existence as of August 31, 1930, at the time of the transfer?

A. Whether or not we have heretofore specifically referred to each of those contracts, as such, in these proceedings, that is my belief.

Q. Yes?

Now, sometime ago, Mr. Watkins, in your testimony, you referred to, if my recollection is correct, some 23 gas sales contracts which were transferred or assigned, if you will, by Mo-Kan to the Panhandle Eastern Pipe Line Company. Is that correct?

A. Yes, I made such a reference.

Q. Could you furnish me with a statement showing the names of the purchasers under these contracts?

A. I could but I would rather refer you to a source where you can get them without my having to do so, if I may.

[fol. 7165] Q. It is satisfactory to me.

A. I believe you will find some substantial detail with respect to those contracts and to the 50,000-odd acres of gas purchase contracts as well in the files of the Internal

Revenue Department having to do with Panhandle Eastern Pipe Line Company's income-tax return for the year 1936 and if it be necessary for Panhandle Eastern to authorize such reference, I shall undertake to supply whatever authorization is required.

I suggest this, Mr. Gorman, because there is a rather substantial amount of detail involved and we are so terribly busy with so many other things that if somehow the Commission's staff could seek the information it wants from that source, it would be a material accomodation to us.

Q: I would be very glad to avail myself of your suggestion, Mr. Watkins, except previous experience in attempting to secure data of a nature similar to this from the Internal Revenue records has demonstrated it is very difficult to accomplish within a very short space of time and, as a contrary suggestion, may I inquire whether or not you have a copy of such income-tax statements which could be made available to me for photostating and return to you?

A: Not here, I do not. I simply have a summarization. If you must do that, we will furnish it.

Q: Well, I meant, do you have one in your office?

[fol. 7166] A: Yes, we will furnish it for you.

Q: I do not want you to think that I am trying to duck you but I have had previous experience with the Internal Revenue Bureau.

A: Well, I would not guarantee that I do not think that but I will get it for you.

Q: And I assume that such data, when it is shown, will indicate the date of the contract with these several customers?

Mr. Wheat: You mean the date of each contract?

Mr. Gorman: Yes.

Is that correct, Mr. Watkins?

The Witness: My remembrance, sir, is that it will not only give that but a great deal of other information concerning each of the contracts.

By Mr. Gorman:

Q: Very well, I think that probably will be sufficient.

Now, you also had previously referred to some 50,000 acres, I believe it was, stated as leaseholds, which were contributed by Mo-Kan to Panhandle Eastern at the time of the transfer in 1930, is that correct?

A. That is correct.

Q. And is it correct that those rights, so transferred, were represented by leaseholds or leases, if you will?

A. They were.

[fol. 7167] Q. And as you have previously indicated, I believe that all such land covered by these leases was located in the so-called Local Area?

A. I believe that is quite correct, sir.

Q. Do you know whether or not the production in the Local Area is presently being made from all or any portion of these 50,000 acres?

A. I would say very definitely that it is not.

Q. That is, it is your opinion that these leases have since been abandoned or surrendered?

A. At least some of them.

Q. To what extent, you are not now prepared to state?

A. I am not.

Q. Now, Mr. Watkins—

A. (Interposing) If I may interrupt, Mr. Gorman.

In determining the number of contracts and the leases representing gas purchase contracts which seem to have been acquired as of September 1, 1930, our approach to that was, a few years ago, in connection with Federal income matters.

There may be some gas purchase contracts or gas sales contracts that were acquired at the time of the substantial contribution of assets by Mo-Kan to Panhandle Eastern that, during the intervening years, we have lost sight of.

If you were to put a question to the witness whether or not, in his opinion, there were a great number, his answer [fol. 7168] would be "no," but it would not quite be proper to say that the list of the 23 contracts we shall procure for you represent exactly the sum total of such contracts coming into the possession of Panhandle Eastern originally and this statement is not made for the purpose of confusing but for the purpose of elucidation.

We are going to give you what we think is the exact number of contracts we received.

Q. That is what I am after, yes.

A. It is sales contracts only.

Q. Yes.

Would your purchase contracts be in a form other than a lease?

A. There were some purchase contracts at or about September 1, 1930, as I have stated, covering lands located in the Panhandle of Texas and southwest Kansas which may have been associated directly or indirectly with this difference between the amounts shown per the books of Missouri-Kansas Pipe Line Company and the amounts assigned to such assets on the books of Panhandle Eastern.

I have tried to simply show that there could have been such a condition without making any specific statement that there was.

Q. Yes.

A. So that the 50,800 acres represented by gas leases [vol. 7169] or leaseholds or gas purchase contracts need not necessarily have been all of the gas purchase contracts at that time.

Q. Would leaseholds or leases have been classified as gas purchase contracts in so far as the account set forth at Line 40 of Page 2 of Exhibit No. 52 is concerned? —

A. In determining the amount set forth there, someone must have given consideration to the instrument or the thing conveyed by the instrument giving Panhandle Eastern a right to buy gas, if there was production on 50,000 acres.

Q. But to what extent or whether or not this was actually done, you do not know?

A. That is a correct summarization of my present knowledge.

Q. And the only place in which your gas purchase contracts would have been reflected would have been in the amount of \$2,398,402.19 which was assigned to these contracts by the Board of Directors on February 3, 1931, is that correct?

A. Except to this extent, when Panhandle Eastern Pipe Line Company acquires a lease, it capitalizes the first cost of the lease—

Q. (Interposing) Just a moment, Mr. Watkins. I do not like to interrupt you but have we not gone through all of the details which make up the total of \$3,053,391.53 and [fol. 7170] the total for other gas sales and purchase contracts amounting to \$553,992.48 and other items of expense in the amount of \$33,130 and in going through such amounts, I do not believe that we have come across any payments actually made as reflected by the exhibits and testimony for the gas purchase contracts which we are now discussing. Is that correct?

A. Limiting our question and answer entirely to the two amounts you just mentioned, that is correct.

Q. Yes.

A. But your question before was a rather broad one, according to my interpretation, dealing with gas purchases.

Q. Well, my question—

A. (Interposing) And we have acquired some substantial rights since September 1, 1930; in that direction and I did not want any confusion to creep into the record in that respect.

Q. Yes. Of course, what I am discussing presently are those gas purchase contracts which are purported to have been transferred by Mo-Kan to Panhandle in 1930 and since we have more or less explained all of the claimed expenditures in connection with either gas sales or gas purchase contracts, without referring in such explanation to detailed items of expenses incurred or claimed to have been incurred for gas purchase contracts, they must, of [fol. 7171] necessity, be reflected solely in the \$2,398,402.19 which was a subject of confirmation by the Board of Directors on February 3, 1931. Do you understand what I am speaking of?

A. I believe I not only understand it but I concur in the statement.

Q. Yes.

Now, as I understand your previous testimony, you do not know nor have you been able to determine from any examination you have been able to make of the records

and books of the company of any specific amount which was allotted to gas purchase contracts?

A. I have not.

Q. And, conversely, of course, as I believe you have previously indicated, you also were not able to ascertain any specific amount which was allocated to gas sales contracts?

A. I have not and, in both answers, we are dealing solely with the—

Q. (Interposing) \$2,398,402.19.

A. That is right.

Q. Sometime previously, in connection with the discussion of the payment made as of August 7, 1936, to Frank P. Parish as shown on Page 1 of Exhibit 153, you mentioned certain advances which had been made to Mr. Parish by the Columbia Oil and Gasoline Corporation; I [fol. 7172] believe, in the amount of \$50,000, did you not?

A. I mentioned such an advance but Columbia Oil and Gasoline Corporation was not involved. The company involved was, I am sure, Michigan Gas Transmission Corporation.

Mr. Culton: That is what you testified.

By Mr. Gorman:

Q. Are you familiar, Mr. Watkins, with the fact that Mr. Beckjord, who has testified in this proceeding, testified to the effect that he was the party who represented Panhandle Eastern Pipe Line Company in the negotiation of the contract with the Detroit City Gas Company?

A. I have not Mr. Beckjord's testimony but I can well imagine he may have made such a statement.

Q. Do you know it to be a fact that he was the party who negotiated such contract?

A. Mr. Gorman, I have heard a great number of people claim that they were solely responsible for the procurement by Panhandle Eastern of the contract with the Detroit City Gas Company.

As a matter of fact, Panhandle Eastern was a party to a suit brought by some gentleman for a quarter of a million dollars who claimed he was the person who procured that contract.

I believe Mr. Frank P. Parish probably would make the statement that he was responsible for it. It may also be [fol. 7173] true that some of the officials of Missouri-Kansas Pipe Line Company might likewise make the statement that they were solely responsible for it.

I further believe that there is no gainsaying the fact that Mr. Beckjord was among the principal participants in the acquisition of the contract and he may have been the one person who did more to turn the trick for us than anybody else.

Unquestionably, Mr. Parish rendered some substantial service or our Board of Directors would not have paid him and Mr. Dupuy G. Warrick the sum of \$100,000.

We do not toss our money about that way. I am sorry, sir, that I cannot categorically tell you that I know exactly who did that job but whoever did it, did a swell piece of work.

Q. Well, from that and your previous statements, may we not properly conclude that it has not been your intention to create any inference that the payment of \$100,000 made to Mr. Parish was in payment for services rendered by him exclusively which resulted in the Detroit City Gas Company contract?

A. I do not believe, sir, that I specified exactly what Mr. Parish's services were. I did make a statement on the circumstances surrounding the payment to Mr. Parish. You have asked that a copy of a letter dated July 6, 1936, [fol. 7174] signed jointly by Mr. Parish and Mr. Warrick be made a part of this record and, when so made, it should speak for itself.

Panhandle Eastern Pipe Line Company's Board of Directors acted upon such a request. The payment was made. This witness has no specific knowledge of the efforts Mr. Parish was making. He knew, in a general way, that he was involved in an effort to sell gas eventually to Detroit and he must have done a pretty good job. He got a lot of money for whatever he did. I would not mind undertaking some task of that sort myself and receiving some such remuneration.

Q. Yes. Since you, yourself, as you just stated, do not know exactly what Mr. Parish's or Mr. Warrick's activities were in connection with the securing of the Detroit City gas contract, you, of course, are unable to say whether or not the statements contained in the letter of July 6, 1936, from Mr. Parish and Mr. Warrick is an accurate statement of their activities in this connection or not, is that correct?

A. I would assume that it was, Mr. Gorman.

Q. I know, merely on the assumption that these men were not falsifying.

A. On that assumption, yes. I do not know what these gentlemen did, any more than I knew exactly what Mr. [fol. 7175] Beckjord did or what Delos G. Smith or any of the members of the Missouri-Kansas Pipe Line Company organization did and I must confess, sir, that all during that whole activity, I had somewhat of a feeling we were throwing money away. Honestly, I did not believe we were going to have a contract with Detroit.

I did not have the feeling that they wanted natural gas and I was among some people that were surprised, when I learned that we had people in Detroit signing the contract.

Mr. Wheat: When you said you did not believe they wanted natural gas, did you mean the company with whom the contract was finally made?

The Witness: Detroit City Gas Company, now Michigan Consolidated Gas Company.

By Mr. Gorman:

Q. Mr. Watkins, in a Registration Statement which the Panhandle Eastern Pipe Line Company filed with the Securities and Exchange Commission under date of September 24, 1941, which is identified as Registration No. 2-4919 at Page S-5, there appears certain notes as an attachment to the balance sheet in this statement.

Now, the first note, "A. (1)" reads as follows:

"Property, plant and equipment is stated at cost except for \$2,417,948.52 thereof assigned by the Board of

[fol. 7176] Directors to assets acquired as of August 31, 1930, as a capital contribution, and intangibles are stated at cost except for \$2,398,402.19 thereof assigned by the Board of Directors to gas sales and purchase contracts acquired as of August 31, 1930, as a capital contribution."

At Page S-5 of the Compiled Registration Statement which is Exhibit No. 145 for identification, the first note thereof which is also a note to the balance sheet and is also identified as "A. (1)" reads as follows:

"Property, plant and equipment and intangibles are stated at cost except for \$4,816,350.71 thereof which was recorded at the amount assigned by the Board of Directors to assets acquired as of August 31, 1930, as a capital contribution. It is the belief of the present management of the company that the amount assigned to the capital contribution represented the value of the assets contributed as determined by the donor, Missouri-Kansas Pipe Line Company. Of the total, \$2,417,948.52 represented the amount at which the contributed tangible property was recorded on the books of the Missouri-Kansas Pipe Line Company, was assigned to property, plant and equipment and the balance of \$2,398,402.19 was assigned to gas sales and purchase contracts."

Now, of course, a comparison of these two notes indicates there has been considerable change in the language. [fol. 7177] I invite your attention particularly to the second sentence of the paragraph which I have last read, namely:

"It is the belief of the present management of the company that the amount assigned to the capital contribution represented the value of the assets contributed as determined by the donor, Missouri-Kansas Pipe Line Company."

Now, since your name appears on this Registration Statement, both the original as filed December 24, 1941, and in the Compiled Registration Statement, Exhibit No. 145, perhaps you can tell us the reason for and the significance of the sentence which I have last read.

A. I can and I will be very glad to do so.

Q. Will you please?

A. To those who have filed Registration Statements with the Securities and Exchange Commission, it is a well-known fact that frequently you get deficiency memorandums with respect to such filing.

I must say here, parenthetically, that our deficiency memorandums, we believe, have been somewhat modest.

A part of the deficiency memorandum received by Panhandle Eastern with respect to the original filing of Registration No. 24919 ran to a request by the Securities and Exchange Commission for the amendment of such Registration Statement to state as nearly as Panhandle Eastern Pipe Line Company could, the basis upon which Missouri- [fol. 7178] Kansas Pipe Line Company had assigned values to such of these capital contributions as are referred to in the note to the balance sheet, both in the original filing and in the Compiled copy of the Registration Statement.

That, sir, is the only purpose of adding the sentence and does not constitute, in this witness' mind, a tremendously important change in the language from the original filing.

It represented purely and simply an effort on the part of the management of Panhandle Eastern Pipe Line Company to satisfy a portion of the deficiency memorandum with respect to the original filing.

Apparently it accomplished that purpose because the Registration Statement became effective January 21, 1942, as of January 12, 1942.

Q. Yes. Can you tell me upon what basis the present management of the Panhandle Company reached the belief that \$2,398,402.19 represented the value of the assets of the gas sales and purchase contracts "as determined by the donor, Missouri-Kansas Pipe Line Company", since that was a determination made by officials and members of the staff of Panhandle Eastern Pipe Line Company and was confirmed by the Board of Directors of that company?

A. Well, there may be some improvidence in the language with respect to that. I do not believe that there was an effort on the part of Panhandle Eastern, in making this [fol. 7179] statement, to involve Missouri-Kansas Pipe Line Company in any manner.

I have quoted to you my remembrance of the deficiency memorandum. Perhaps I stated incorrectly that the request of the Securities and Exchange Commission was to state the basis of a determination by Missouri-Kansas when actually, I believe, it was a request for us to state the basis upon which the Board of Directors assigned this amount in its determination on February 3, 1931. As you may well imagine, it was very difficult, from the somewhat meager records we have concerning this particular item and for the further reason that very few, if any, of the Directors of the company at February 3, 1931, are now Directors of the Company, for us to do other than try to ascertain, as best we could, what might have been the basis upon which the Board did take such action.

Q. Well, is this sentence to which I have been making reference intended to represent that the assignment of \$2,398,402.19 to gas sales and purchase contracts was determined by the Missouri-Kansas Pipe Line Company as representing the value of these assets?

A. Mr. Gorman, let me try to answer that, if I may, if I can do so, in a common-sense sort of way.

Q. I might state that my present state of confusion is brought about entirely by the fact that throughout the day [fol. 7180] we have been discussing the fact that these determinations were made by officials and Directors of the Panhandle Company, not Missouri-Kansas Pipe Line Company.

A. Is it not true also that in the general statement this witness made quite earlier in the day concerning the gas sales and purchase contracts, that there must have been an effort on the part of the mind of somebody in setting up these entries to cause their general effect to coincide in some degree or in some manner or in some respects with the determination by a buyer and a seller of a value at which these two parties were to determine the cost to one and the amount to be received by the other of one-half of the then-outstanding shares of the common stock of Panhandle Eastern Pipe Line Company.

Now, as nearly as we have been able to do so, from the information we have, it would appear to us that the difference between the amount at which the gas sales and purchase contracts were carried on the books of Missouri-

Kansas Pipe Line Company and the amount at which they appeared in the records of Panhandle Eastern Pipe Line Company could have very well represented the difference between the sum of a certain number of specific assets that Mo-Kan was donating and the amount it included in its computation and which must have been agreed to by the buyer of one half of the interest in Panhandle Eastern, so [fol. 7181] that in recording this amount, consideration was given to that fact.

Now, the language that you observe in the Combined copy of the Registration Statement is intended to encompass such a situation as that and does not, as the witness has stated, intend to involve Missouri-Kansas Pipe Line Company in any manner whatsoever.

Q. And is it upon the basis, that such statement in the Registration Statement was made, upon the basis of the conclusions which you have just mentioned?

A. Those, among others. We tried to find exactly what the Securities and Exchange Commission wished. We, as the witness has said, were not Directors, none of the officers, that is, none of the senior officers were officers at that time.

We could not obviously find all of these people who were Directors and examine them. We did the very best we could. This is the result. It seems innocuous to us.

Q. Well, it may be that I have read it improperly but, as I read the sentence which I have been discussing, it is a very definite statement that the valuation of assets amounting to \$2,398,402.19 for gas sales and purchase contracts was made, not by the Panhandle Eastern Company or its officials or Directors, but by the Missouri-Kansas Pipe Line Company.

A. I do not believe one could characterize language [fol. 7182] beginning as this does in this fashion and I quote, "It is the belief of the present management", to be so specifically construed as you have construed it.

Q. Well, of course—

A. (Interposing) Please excuse me.

Q. Yes, indeed.

A. Now, Missouri-Kansas Pipe Line Company had something to sell. It put a price upon it. Part of that price

probably was these gas sales and purchase contracts, perhaps at some determination other than actually shown by its books.

That fact, I believe, will be borne out by some of its income tax returns filed with the Internal Revenue Department. In one of such returns may be found a statement where it computes to it the cost of the things it was obligating itself to turn over to Panhandle Eastern Pipe Line Company without cost to Panhandle Eastern at the time it sold one-half interest to Columbia Oil and Gasoline Corporation and to that extent, this seems a very proper statement for the officers of Panhandle Eastern Pipe Line Company to have included in the Registration Statement.

The statement likewise is a part of the notes to the balance sheet which has been certified to by the company's public accountants and they are just as cautious as the company.

[fol. 7188] Cross Examination (Continued).

By Mr. Gorman:

Q. Mr. Watkins, in your testimony of yesterday, I believe it commenced at Page 7062 of the transcript and on certain succeeding pages, you were discussing and made statements to the effect that if you had been better advised of the purpose for which Mr. Biddison requested information as to the cost of business development; instead of furnishing him with the statements which aggregate some \$553,000, you would instead have furnished him with a statement which you outlined in detail which, instead of the \$553,000 odd would have aggregated approximately \$2,408,000.

That is generally correct, is it not?

A. That is generally correct except Mr. Biddison's request, as I recall it, made no reference to cost of business development.

He simply asked for payments made to utility companies.

Q. Yes. May I inquire whether, in introducing those statements of yours in this record, there was any intention on your part of contending for consideration of the amount of \$2,408,000-odd instead of the amount of \$553,000-odd which Mr. Biddison has set forth at Page 966 of his Exhibit No. 39?

[fol. 7189] A. Mr. Gorman, I believe a proper statement for this witness to make is, that in the introduction of facts with respect to Panhandle Eastern Pipe Line Company or its operations or its combined operation, it has been my purpose to supply, in connection with these proceedings, factual matter for whatever use to which it may be put.

Specifically with respect to the \$2,408,000 amount as contrasted with the \$553,000 amount, both being approximate figures, the witness attempted to show you the data he would have supplied to Mr. Biddison in the examination referred to at Page 7062 of the transcript of yesterday's proceedings and the pages succeeding that page, rather than the amount he did supply and then it would have been up to Mr. Biddison to treat with it in any manner he saw proper.

Q. Well, in so far as your present intentions are concerned with respect to the testimony relative to this item, you are not here proposing the substitution of the figure of \$2,408,623.50, to which you testified yesterday, rather than the figure of \$553,992.48, which is the total figure of payments to utility companies shown at Line 30 of Page 966 of Exhibit No. 39?

A. I believe that is a correct statement of fact. However, it does occur to me that consideration should be given to the \$2,408,000. I should judge that in a proceeding of this kind, the Commission, as well as the public, as well [fol. 7190] as the company, wants the facts known and that any final determination would naturally take those facts into consideration.

Mr. Gorman: Yes.

May I inquire of counsel for the Panhandle Eastern Pipe Line Company whether or not there is any such contention on their part that this amount of \$2,408,623.50, to which reference has been made by Mr. Watkins, should be substituted for the figure of \$553,992.48?

Mr. Wheat: Mr. Gorman, we believe, of course, that all facts brought out in this record ought to be considered and we shall, of course, make whatever contentions we feel are proper at the conclusion of the record in whatever briefs may be filed or in arguments made before the Commission.

I am not now advised as to the incidence of all these facts and I am, therefore, unable at the moment to answer you directly on the point.

Mr. Gorman: My query, of course, was propounded with the thought that if the figures shown at Line 30, Page 966 of Exhibit No. 39 are contended to be erroneous by counsel, then I think Commission counsel, the Examiner and all others participating in this proceeding should be so advised so they may treat with that item accordingly.

Mr. Wheat: Nobody has suggested it is erroneous. The [Vol. 7191] witness has suggested that possibly there are other facts which should be taken into consideration with it. That is the point which I wish to express to you.

Mr. Gorman: Of course, we all appreciate the fact that the Commission, in its final determination, will give consideration to any pertinent fact.

Mr. Wheat: Surely.

Mr. Gorman: But my inquiry is as to whether or not we should treat Exhibit No. 39 in this respect as having been corrected to the extent that Mr. Watkins has testified in his testimony of yesterday.

Mr. Wheat: To the extent to which Mr. Watkins' testimony can be considered a correction, and I am not sure that he suggested that, as such, why, I think the facts testified to by Mr. Watkins should be considered, of course, along with all the other facts in this proceeding.

By Mr. Gorman:

Q. Mr. Watkins, I should like to invite your attention to certain statements given by Mr. Biddison in his testimony in this proceeding on September 4, 1941, commencing at Line 25 of Page 554.

I might say for the record this is a part of the direct testimony of Mr. Biddison.

Mr. Culton: I wonder if we might not borrow the Examiner's copy so he can follow you.

[fol. 7192] Mr. Gorman: Yes, indeed. That is Page 554, September 4.

By Mr. Gorman:

Q. Do you have the place, Mr. Watkins?

A. I do.

Q. (Reading).

Q. Now, will you turn to page 966 which you have headed: 'Cost of Business and Development', and tell us what is included on that page?

A. Upon the completion of a natural gas line, business does not just walk down the street and attach itself. It takes effort to attach business. It takes time to attach business and costs money to attach business.

Q. Is there usually some lag of that sort?

A. It is almost inevitable. I know of one or two exceptions, where business was immediately attached to substantially the capacity of the business, but those are very rare.

Q. In general, it takes five years or more to develop the business for which a line is constructed.

Q. On this particular system, in order to develop business, and in line with what is being proposed on more recent construction, payments were made to some of the distribution utilities to aid them in their sales campaigns for industrial gas, for house heating gas, and contributions were made to bear part of the cost of their changing over their systems from manufactured gas to natural gas.

[fol. 7193] Q. I have listed, on page 966, a statement, beginning at line 2 and ending in a total at line 30, of such payments made to utility companies. The purpose of the payment is generally shown.

Q. You mean payments actually made by Panhandle Eastern Pipe Line Company?

A. Yes, sir.

Mr. Wheat: By the way, Mr. Gorman, that refers to the table totaling \$553,000-odd that was referred to yesterday in the witness' testimony?

Mr. Gorman: That is correct and is shown, as indicated in this testimony I have just quoted, at Page 966 of Exhibit No. 39.

Mr. Wheat: Thank you.

By Mr. Gorman:

Q. In view of that statement of Mr. Biddison's and his intent with respect to his presentation of that part of his Exhibit No. 39, do I understand correctly that it is your opinion that the cost of attaching business should include payments made by the Missouri-Kansas Pipe Line Company for contracts which it acquired?

A. Mr. Gorman, this witness has given no specific testimony that he remembers with respect to any representation as to what the cost of business development should include nor is he entirely familiar with the treatment given any items which may have been furnished by him to Mr. Biddison and used in connection with Exhibit No. 39 on Page 966 or elsewhere therein.

If you wish my personal opinion—

Q. (Interposing) I am asking the opinion upon which you made the statement it was your belief that the amount should have been \$2,408,623.50—

A. (Interposing) Let's get our facts straight, sir.

I did not say it was my conclusion that Mr. Biddison should have used \$2,408,000. The record does not show that.

Q. Well, I beg to differ with you in that respect.

A. You may do so—

Q. (Interposing) May I refresh your recollection as to what you said yesterday. At Page 7062 you said, in discussing this item:

"It did not dawn on me and I did not awaken to the fact that perhaps what Mr. Biddison was requesting was the total amount of such payments from the very inception of the company until I had occasion to take a quick glance at a portion of his testimony.

"So, as I stated before, had the question been put subsequent to such knowledge on my part or had my thoughts at the moment been a little bit more mature than I now see

they were, the total we would have given to Mr. Biddison [fol. 7195] would have been on the order of \$2,408,000 and I should be very glad to supply you what seems to me to be the items that constitute that total, if you wish them."

That, to my mind, is a very clear and definite statement that it is your belief that the figure, instead of \$553,992.48 should have been "on the order of \$2,408,000."

Is that an incorrect reading of your language there?

A. I believe it is an incorrect conclusion, certainly. My language was a simple statement that my present interpretation of the request put to me by Mr. Biddison, which resulted in the furnishing to him of certain information aggregating \$553,992.48, was improper, and in the light of further consideration and of the facts that have developed since, had such question now been put, the answer would have contained the items placed in the record yesterday aggregating slightly more than \$2,408,000.

How any other construction could be placed on the statements made by the witness at Page 7062 is something the witness cannot understand.

Q. Yes. Now, you took exception to the phrase "cost of business development." Of course, in reviewing Mr. Biddison's testimony, as you indicated you did and obviously in connection therewith, considered this Page 966 of Exhibit No. 39, you did know the purpose which Mr. Biddison put this information to and the stated purpose for which [fol. 7196] he proposed it to be used, did you not?

A. I not only knew it then but I think perhaps I might have known it at the time he asked for it.

Q. Yes.

A. However, he was the gentleman that treated with it. Now, as I started to say a short while ago, if you would like my expression of what might have been the cost of business development to Panhandle Eastern Pipe Line Company, I do not believe it is yet in the record because certainly we have a situation with respect to our company where some consideration should be given to the year up to the time when the company began to make some sort of a profit that could be represented as a return to the stockholders.

I am not testifying with respect to the cost of business development. I simply give you a slight indication of what my view might be with respect to that particular item.

Q. So, of course, from this and your previous statements, we may properly conclude that you have not and do not now intend to offer the figure of \$2,408,623.50 in substitution for the figure shown at Line 30 of Page 966 of Exhibit No. 39?

A. As stated before, Mr. Gorman, the purpose of showing that amount was because the witness wished to have the record disclose what he believed was information that the Commission, the company, the intervenor, the City of [fol. 7197] Detroit, Wayne County, or any other participant in these proceedings might reasonably require for a proper and equitable determination of any questions involved in these proceedings.

Q. Is the answer to my question, Mr. Watkins, no, that you do not propose such substitution?

A. Only to the extent that I have qualified heretofore.

Q. Well, as I understand your qualification, you have submitted your testimony with respect to these figures for whatever use they might be put by the Commission?

A. I believe that is a correct statement, sir.

Q. And that in so far as your intent is concerned, you have not directly proposed it to be a substitution for the figure which we have been discussing as shown on Page 966 of Exhibit No. 39?

A. Not directly, no, sir.

Q. There is a further question, Mr. Watkins. Yesterday we discussed at some length various contracts of the Panhandle Eastern Pipe Line Company. May I inquire whether or not those contracts that we were discussing, so far as they are presently effective, are they the ones which are reflected on Exhibit No. 60?

A. Did we discuss contracts, as such, sir, or only as they might have been involved in certain other matters we were discussing yesterday? It does not seem to the witness that it is quite proper to say that we discussed the contracts, as such. Reference was made—

Q. (Interposing) Well, we made general reference to certain contracts. Exhibit No. 60 is in two parts, one of which deals with sales agreements with other gas com-

panies as at June 30, 1941, and the second portion deals with sales agreements with industrial customers as at June 30, 1941.

A. And your question with respect to the contracts shown on Exhibit No. 60 is in connection with the amount shown on the company's books in the account, "Gas Sales and Purchase Contracts"?

Q. That is correct.

A. They are not necessarily the same at all because there are many contracts included in Exhibit No. 60.

Q. Yes. Well, of course—

A. (Interposing) That had no reference whatever to the amounts carried by the company in its gas sales and purchase contracts.

If I may repeat a portion of what I believe I said yesterday, subsequent to August 31, 1930, save for a very small amount of dollars charged to gas sales and purchase contracts, it was not the accounting practice of the company to charge cost incident to the acquisition of such contracts to an asset account and hold it in such account for gradual amortization.

[fol. 7199] That practice continued until about the time the company, as a matter [—] fact after the time the company acquired a contract on August 31, 1935, with Detroit City Gas Company, now Michigan Consolidated Gas Company, and it was then changed only to the extent that in instances where a specific contract required, on Panhandle Eastern's part, a payment of some nature, that those amounts were charged to an asset account and held for gradual amortization.

The witness tried to show yesterday that there were many other such costs that were not so treated. They were absorbed as incurred through operating expenses.

As you no doubt know, we are constantly dealing with the acquisition of leases, sales contracts and purchase contracts. In the ordinary course of business, we make no effort whatever to accumulate the cost of such acquisitions in an asset account and amortize it over the natural life of such contract.

Does that answer your question, sir?

Q. Yes, I think so. Of course, my only purpose in raising the point at all was merely to indicate on the record that the exhibits which we discussed yesterday, in so far as they related to particular contracts, those contracts were explained somewhat in Exhibit No. 60.

A. Except to the extent, sir, that the witness tried to show that in fixing at least a part of one of those amounts [fol. 7200] at the time the original entry was made, there may have been some contracts, either purchase or sales contracts, that were included in the difference between the two amounts that we cannot definitely put our fingers on.

[fol. 7208] Q. And you went to work, if I understood you correctly, for the Management Company of Columbia Gas in 1926?

A. Mr. Irvine, who was the manager of the Cincinnati [fol. 7209] office of Ernst & Ernst, persuaded me, in 1926, to become a member of his staff. Mr. Irvine at that time had left Ernst & Ernst and had become the general auditor for Columbia Gas & Electric Corporation and its subsidiary companies.

He was organizing a staff and he was going to develop certain different departments and what not. He did not know just exactly where he was going to put what person and I first went into the organization on the payroll of Columbia Engineering & Management Corporation.

My remembrance at this moment is that the first assignment I received under Mr. Irvine was a course of study, so to speak, that consumed a month or some period up until about the time Columbia Gas & Electric Company and Ohio Fuel Corporation—those names may not be precise, sir—

(Continuing) —were merged in late 1926 and my activities after that merger drifted into budget work for the newly-merged system.

My scene of activity was changed shortly thereafter from Cincinnati to New York although my residence was retained at Cincinnati. About 90 percent of the time I was engaged in this assignment; my duties were wholly in connection with the installation of operating and construction budgets

in the various group offices of the Columbia Gas & Electric Corporation organization.

[fol. 7210]. That continued until perhaps the year 1927 or 1928 when the management of the Union Gas & Electric Company at Cincinnati asked that I be returned to that organization permanently.

That did not displease me because my family was at Cincinnati. I did not care for this jumping around over the country too much although the experience was quite valuable. I had a great admiration for the management at Cincinnati, as well as the management of the other groups of Columbia Gas & Electric Company so, altogether, I was quite satisfied to go back to Cincinnati.

Q. Then your engagement with Columbia Engineering and Management Company was very shortly after its organization and while it was in a formative period?

A. Yes, but its records might show differently and, if you will permit me to do so, I will develop that fact for you.

Upon returning to Cincinnati, I became assistant treasurer of Union Gas & Electric Company and all of the subsidiaries of the Columbia organization whose headquarters were lodged in the Cincinnati office and retained that office until November 17—no, that is not correct—I was sent to Kansas City to learn something about an organization that I really never had heard anything of with the understanding that I probably would be there about two weeks. This was in November, 1931.

[fol. 7211]. When I now look back over the years, I am aware of the fact that I never did get back to Cincinnati but my connection with Union Gas & Electric, according to its records, probably continued until the next annual meeting of the officers which probably was in the early part of the year 1932.

Now, after becoming connected with Panhandle Eastern for some internal purposes, my name was still carried on the organization rolls of one of the Columbia companies, I do not recall which, and the specific and only purpose for that was so that I might enjoy the benefits of a group-life insurance certificate that was issued to me in Cincinnati until such time as Panhandle Eastern might have some

plan of that sort itself and that was the sole purpose for that and I merely mention it so that, if someone reviewing the records ascertains when my name last appeared on the rolls, they would not be misled.

Q. It was my recollection that the Management Company was organized about December 1, 1925.

A. I have no specific knowledge as to that, sir.

Q. Well, you are aware, of course, that you were developing the personnel of the company in 1926?

A. I was a part of the personnel being developed, sir.

Q. Yes, and during that period, your staff developed [fol. 7212] the system of budgetary control that is still in use, did they not?

A. Well, we perhaps had something to do with the development of the system that is being used. Whether it is being used in the exact manner in which we developed it, I rather seriously doubt because, over the period of years, they must have worked some rather marked improvements in the system.

If I know those people very well, that was the natural outcome of any attention they would give to a thing that was installed in 1926 and still is in effect at this time.

Q. To what extent do you follow the construction and operating budget forms that you developed—I mean, to what extent did you follow them in Panhandle Eastern?

A. The staff of Panhandle Eastern at the time I appeared on the scene was composed of certain employees who likewise had been connected with the Columbia Gas organization in some fashion and the budget forms which the Columbia Companies had been using prior to the connection of those gentlemen with Panhandle Eastern were in effect when I appeared.

There probably is some great similarity even to this day between the two sets of forms used by the two companies. We have improved them. We have discarded certain things that that organization may have used. Altogether, naturally, having had something to do with the birth of the system, I should not say that it was worthless.

Q. Then, in the early period of your employment, you did go into the New York office there for a time?

A. That is quite true and, as the record will show, I likewise returned to New York in 1934, I believe it was, and served in a dual capacity as an officer of Columbia Oil & Gasoline Corporation and its subsidiary companies and of Panhandle Eastern Pipe Line Company and its subsidiary companies.

Q. Your offices then, and I speak of the offices of the Management Company, were with those of Columbia Gas & Electric Corporation?

A. At that particular time, 1934 to 1937, sir, nor subsequent to the time I returned to Cincinnati, as I explained before, I had no connection with the Management Company and we are speaking of Columbia Engineering & Management Company?

[fol. 721] Q. But what I was addressing my question to was as to your own personal contacts there during the period from 1926, was it, to 1928 that you were in New York?

A. It was sometime, Mr. Chamberlain, in 1927 and a part of 1928, as well as I recall at the moment.

Q. But the offices were all together, were they not, that is, the Management Company and the Gas and Electric Corporation had the same offices?

A. They occupied the same quarters, whether or not they had the same offices, I do not recall.

Q. Well, they were close, on the same floor, were they not, the same building?

A. Yes, that is correct.

[fol. 721] Q. Who asked you to go to Kansas City to look into the affairs of Panhandle?

A. Well, it came about somewhat like this: I was called into the office of the treasurer one afternoon about 4 o'clock and a conversation was going on over the telephone. The treasurer turned to me and asked me if I could be prepared to be away from home for about ten days or two weeks and, very naturally, my response was yes, so the next I heard was: "Buy a ticket tomorrow from

Dayton to St. Louis and meet Mr. E. B. Flahive on the train leaving Dayton about 1:30 or something like that. Mr. Flahive will tell you where you are heading."

Mr. Flahive was at that time treasurer, I believe, of Columbia Gas & Electric Corporation. He was perhaps also treasurer of Columbia Engineering and Management Corporation. He may have been an officer or director of [fol. 7218] a great number of other companies and he might even have been connected with Panhandle Eastern.

The surprising part of the whole thing was, about the time I got ready to leave, the treasurer handed me a little package and said, "Here is a little present for you." That did not look like a two-week trip, so to make a long story short, I met Mr. Flahive on the train, hit Kansas City November 17, 1931, and have been connected with Panhandle Eastern ever since and I hope I shall be able to be connected with it all my life.

I have enjoyed the work thoroughly, have a wonderful company with wonderful potentialities.

[fol. 7219] Now, I wish you would read into the record, unless it is already there, the list of the officers of Panhandle Eastern at the time you went there, and as you read them, state whether or not they were connected with the Columbia Gas Organization.

[fol. 7220] The Directors were Frank P. Parish and, I believe, you will agree that he had no connection with Columbia Gas.

Q. I am sure of that.

A. E. I. DuPont, and I think the same situation may be said to be true with respect to Mr. DuPont—

S. A. Russell—as to Mr. Russell's connection with Columbia Gas, I am ignorant.

Mr. William G. Maguire—I do not believe you would say that Mr. Maguire had any connection with Columbia Gas.

Mr. R. W. Crawford—Mr. Crawford may have been an officer of Columbia Gas. At any rate, he was an officer of Ohio Fuel Corporation which was a part of the merged Columbia Company.

Mr. T. G. Gregory—Mr. Gregory was at one time a Vice President of Columbia Gas and many of its subsidiaries [fol. 7221] or held office in some of its subsidiaries. I think it could properly be said he was connected with Columbia Gas.

Mr. E. Reynolds, Jr.—Mr. Reynolds was certainly connected with Columbia Gas because he has been an officer of Columbia Gas ever since I have known anything about the organization and is at this [moments] its President, I believe.

Mr. T. R. Weymouth—now, Mr. Weymouth apparently became a Director of Panhandle about November 30, 1931. That would be shortly after I became connected with Panhandle Eastern and Mr. Weymouth, according to my information here, succeeded Mr. C. A. Munroe. You know Mr. Munroe. You know that he was President of Columbia Oil & Gasoline Corporation. I do not recall at this moment whether he was ever an officer of Columbia Gas & Electric Corporation or not.

There was a vacancy as a result of the resignation of Mr. H. G. Howard. Mr. Howard, apparently, resigned about the 4th of November, 1931, or at least at a Director's meeting held that day, his resignation was put in, it is apparent from the memorandum I have here. Now, I do not know much about Mr. Howard except hearsay. Wasn't he connected with one of the financial institutions or organizations in New York?

United Corporation, I believe, at the moment owned [fol. 7222] some of the stock of Columbia Gas & Electric Corporation. Whether or not it did in 1931 is something I do not know so I could not state specifically whether or not Mr. Howard had any direct or indirect connection with Columbia at that time.

Mr. B. R. Bay was Vice President and Mr. Bay, so far as I know, had never had any connection with Columbia

[fol. 7223] Gas & Electric Corporation. I believe his origin in Panhandle Eastern Pipe Line Company's affairs was from the Cities Service organization or some of its affiliates or subsidiaries.

Mr. R. G. Crandall was likewise a Vice President and Mr. Crandall was a member of a firm of attorneys whose offices were located in Chicago and I do not believe anybody could say that they had had any connection with Columbia Gas & Electric Corporation.

Mr. A. W. Leonard was likewise a Vice President. Mr. Leonard originally came, I believe, from the same general territory in Pennsylvania from which the Crawford family originated and he may at some time have had connection with some of the Columbia companies, either directly or indirectly. I do not know. At the time of he was connected with Panhandle Eastern, he had been loaned to the organization to assist it in the completion of its construction program and did a swell job.

Mr. E. Reynolds, Jr., was a Vice President at the time— [fol. 7224] Yes; he was likewise Secretary. Mr. Reynolds, as we have stated before, was also a Director and was very closely connected with Columbia Gas.

Mr. Seyffert, whose name you mentioned a short while ago, was Treasurer of Panhandle Eastern Pipe Line Company and Mr. Seyffert, at the time, I believe, held offices with some of the Columbia companies located at Columbus, Ohio.

[fol. 7225] (Continuing) And, of course, he has, as we have stated, had connection with the Columbia Gas & Electric Corporation or its subsidiaries.

Mr. H. H. Pell, Jr., was an assistant secretary of Panhandle Eastern Pipe Line Company and Mr. Pell at the time was, likewise, an officer of some of the Columbia Companies and one of the hardest workers I believe I have ever come across.

Mr. F. B. Flahive, as we have stated, was assistant treasurer of Panhandle Eastern Pipe Line Company.

Then, there was yours truly, who was, likewise, an assistant treasurer.

[fol. 7226] Now, what was the fact with respect to who did the actual secretarial work after you were elected assistant secretary and took up your residence at Kansas City?

A. The board meetings were not held at Kansas City. The secretarial work was, no doubt, done by the secretary of the company, or one of its assistant secretaries located at the point where the meetings were generally held. I knew nothing of the minutes of the board meetings until we received copies of them at the Kansas City office.

[fol. 7227] Q. Now, there was a reorganization of the Columbia Oil & Gasoline Corporation board the day after the Securities and Exchange Act was put into effect, was there, not?

A. Well, I do not know, sir. I cannot connect those two things together.

As to Columbia Oil & Gasoline Corporation's affairs, I shall not be able to testify in connection with these proceedings. I am not an officer of the company and I have nothing to say about its affairs. I became an officer of Columbia Oil & Gasoline Corporation, I believe, about May, 1934. I continued to be an officer of Columbia Oil & Gasoline Corporation and its subsidiary companies until February 10, perhaps of 1937.

Q. Well, you were elected as a director and secretary and treasurer of Columbia Oil & Gasoline Corporation on June 7, 1934, were you not?

A. I do not remember the exact date. I think perhaps that is the correct date that I was elected to those offices.

[fol. 7228] Q. And you acted as secretary-treasurer and director until some time in 1938, did you not?

A. 1937, sir. The early part of 1937.

Q. Now, who was it who asked you to become an officer of Columbia Oil & Gasoline Corporation?

A. Well, there, again, sir, it was not so much a request as it was direction. That circumstance came about somewhat after this fashion:

Mr. Charles A. Munroe, and several of the other directors of Panhandle Eastern Pipe Line Company visited its offices in Kansas City, perhaps it was in April of 1934, and during the course of that visit Mr. Munroe stated to me that I should report the next Tuesday at 61 Broadway, New York City, because I was to become an officer of Columbia Oil & Gasoline Corporation. There was no alternative left as to whether I wished to become one or not, and I cannot say that I particularly regret the fact that I was an officer of that organization. I had some rather interesting experiences then and have since connected with its affairs and Panhandle Eastern's. They were very instructive, as well.

Q. Mr. Munroe had become an officer of Panhandle Eastern, then, after his resignation in 1931?

A. It seems that Mr. Munroe became a director of [81,7229] Panhandle Eastern about May 5, 1932, and remained the director of Panhandle Eastern until January 31, 1936, which was a day or so after a certain consent decree was entered, and I imagine we may hear more of that in these proceedings.

Q. Yes. That is my recollection, that he again went on the Board. Did he become an officer after 1932?

A. An officer of Panhandle Eastern?

Q. Yes.

A. I do not believe that he did.

Q. Well, then, you recognize the orders of Mr. Munroe, although he was but a director of the company?

A. At the time Mr. Munroe spoke to me there was present with him an officer of the company.

Q. Who was that?

A. Mr. E. Reynolds, Jr.

Q. Yes.

A. Who, at that time, was secretary.

Q. And vice-president?

A. Of Panhandle Eastern, yes, he was vice-president at that time.

Q. Well, at that time Mr. Reynolds was vice-president of Columbia Gas & Electric Corporation, was he not?

A. He may have been; he was vice-president of Columbia Gas & Electric Corporation.

[fol. 7230] Q. Well, he was, also, an officer of Columbia Oil at that time, was he not?

A. I think he was secretary of Columbia Oil at that time. He may have been a director of Columbia Oil, as well.

Q. Let me withdraw that. Does the incident of this conversation bring to your mind a statement made by Mr. Reynolds and Mr. Munroe as to why they were putting you on the Columbia Oil board?

A. This thing comes to my mind, that in causing Leith Watkins to become connected with Columbia Oil & Gasoline Corporation, as well as Panhandle Eastern, there was a very definite effort being made to save a few dollars, and that statement was made rather clearly to me.

Q. That is strong in your mind?

A. That is correct. In connection with that they just [fol. 7231] worked the devil out of me.

Now, as to why I was becoming a director, I could surmise, but no definite statements were made. Maybe I was foolish enough to think that perhaps I could be of some assistance. I knew of the affairs of Panhandle Eastern. I had been with it for quite some while. It was so inexorably all meshed up in my life that it meant quite a lot to me and still does, and, as I have said before, I hope if ever shall.

Perhaps it was worth while to have someone on the Columbia Oil board that knew something of the affairs of Panhandle Eastern, because Columbia Oil, after all at that time had a substantial stake in the company and it wanted to know something about what was going on. There was a similarity of duties and functions and procedure with respect to the accounting affairs of Panhandle Eastern, as well as Columbia Oil & Gasoline Corporation. It was of some material assistance to me, as an officer in charge of that phase of the work of both of those organizations and the subsidiary companies, to have knowledge of what the other was doing, because it was not infrequent that I used the employees of those two companies interchangeably to effect economies and to eliminate rough spots, and so forth, in the organizations.

If, perchance, I saw a lad in the Kansas City office of [fol. 7232] Panhandle Eastern that could do us a rather nice service in the office of Columbia Oil & Gasoline Corporation down at Charleston, I sent him over there for that purpose, had him do that particular job, get it under way and go back to his own duties. That was true, likewise, with Columbia Oil & Gasoline Corporation's forces.

Q. The conversation you mentioned with Mr. Munroe and Mr. Reynolds was at Kansas City?

A. It was.

Q. And were you in New York at the meeting of Columbia Oil & Gasoline Corporation on June 7, 1934?

A. I think unquestionably I was.

Q. Now, at that meeting all of the officers of Columbia Oil, who were at that time officers of Columbia Gas, resigned, did they not?

A. I shall accept your statement, sir. I must, again, insist that I am not a witness in these proceedings to testify with respect to the affairs of Columbia Oil & Gasoline Corporation, and were I permitted to make such a statement without seeming to be officious, it would occur to me that they are irrelevant, immaterial, and so forth.

[fol. 7233] Q. Well, I am unable, Mr. Watkins, to change rules of law here to conform to what may be your wishes about these matters, but I must ask you as to facts within your knowledge.

A. I do not recall, sir, exactly what happened at that meeting. It was many years ago and there had been a multiplicity of things happen. I have had my hands in what seems to me like a million different things, and I do not specifically recall what happened at the meeting.

Q. Will you refresh your recollection by looking at the annual reports of Columbia Oil & Gasoline Corporation now before you, and tell me in what way the Board of Directors was changed at your meeting of June 7, 1934?

A. You have supplied the witness with a copy of the annual report of Columbia Oil & Gasoline Corporation which shows, in part, on page 2, apparently it is, that the officers of Columbia Oil & Gasoline Corporation at the time such report was issued, which—

Q. Mr. Watkins, I am not asking you to read from that at all. I am asking you to refresh your recollection.

A. The only way I can refresh it is to look at this report—

Q. Of that meeting?

A. This report was apparently issued on March 30, 1934. I had nothing to do with the affairs of Columbia [fol. 7234] Oil & Gasoline Corporation in 1933, and if I must answer a question concerning the affairs of that company as of that date, I must refer to something and you have given me a report to refer to.

If you wish this witness to state the officers and directors of that company as of or about that time, he can only do so by reading from this report.

Q. Mr. Watkins, did you testify before the Securities and Exchange Commission in a recent hearing with respect to the exemption of Panhandle Eastern as a subsidiary of the Columbia system?

A. I may have testified to the extent of introducing some documents only. I do not recall, Mr. Chamberlain, that I gave any testimony in that proceedings with respect to whether or not Panhandle Eastern should be exempted. My remembrance at the moment is that the only purpose for which I was used was, perhaps, to identify documents.

Q. Have you read the findings in the hearing in that matter, which is Release No. 2778 and Exhibit 14 in this case?

A. I probably have.

Q. I now lay before you a copy of that Release, and ask if that refreshes your recollection as to what was done at that time?

A. We are now referring to the meeting of Columbia [fol. 7235] Oil & Gasoline Corporation that occurred on June 7, 1934?

Q. Yes, sir.

A. According to page No. 7 of the Release, to which counsel has referred—

Q. (Interposing) Mr. Watkins, I am not asking you to read that. I am asking you if it refreshes your recollection.

A. It does by reading it, sir.

Messrs. Harrop, Watkins, Philips & Munroe constituted the new Columbia Oil board.

Q. Then, at that time Mr. Reynolds resigned, did he?

A. I presume he did, if he was a director before, and I think he was. I believe, further, he was an officer.

Q. And Mr. Munroe resigned as a director of Columbia Gas, did he not?

A. That I do not know.

Q. You cannot remember that?

A. Mr. Chamberlain, I do not know anything about the affairs of Columbia Gas & Electric Corporation. I wasn't at any of its board meetings. Mr. Munroe may have been a director of Columbia Gas, he may have been a director, I do not know specifically, nor do I know when he resigned. I would assume that he did, and my assumption is based on this fact; that the possible further severance of the connection between Columbia Oil and Gasoline Corporation and Columbia Gas & Electric Corporation was intended to be a part of the result of the transactions that took place at this June 7, 1934, meeting; assuming that to be the proper basis of the action that took place there, it would follow that Mr. Munroe would certainly resign from the board if he were on such board.

Q. Then, you do recall that the purpose of the meeting was to sever the relations there, in so far as the two companies were concerned, do you not?

A. I have no notice. I received no notice of the purpose of the meeting. I do not recall that Columbia Oil's by-laws at that time, nor do I recall that their by-laws during the time that I was an officer of the company required that notices of any of its meetings need state the purpose of such meeting.

I was not informed prior to the meeting what its purpose was. What I learned about the meeting was during the process of the meeting.

Now, my memory is not perfect enough to tell you specifically exactly what happened or the purpose of the things that did happen.

Q. The minutes of the meeting were in your custody for some three years, were they not?

A. Oh, yes; but-I made no effort to make such a card [fol. 7237] index of my mind that I can instantly pluck from it incidents that occurred eight years ago. There has been so much happened, I have been involved in so many things of what seemed to be matters at the moment, that I feel that a job done is finished, behind, and put on the shelf.

Q. Is your memory clear as to what happened with respect to the resignation of Columbia Gas directors from Panhandle Eastern's board in 1934?

A. I can refer to the memorandum that I quoted you of the officers and directors a few moments ago and tell you what happened to them.

[fol. 7238] Q. I am asking you whether or not every director of Columbia Gas who was a director on the board of Panhandle Eastern did not resign in the year 1935?

A. I do not know.

Q. Well, will you look and see?

A. Here are the changes in the year 1935.

Q. Let's save time here. Did Mr. Reynolds resign?

[fol. 7239] A. Mr. Reynolds apparently was not a director of Panhandle Eastern Pipe Line Company at any time during the year 1935.

Q. Then, he must have concluded in 1934?

A. According to my information Mr. Reynolds was not a director of Panhandle Eastern Pipe Line Company subsequent to the directors' organization meeting in 1932, which occurred about March 29 of that year.

Q. He was vice-president and secretary, at that time, in 1934?

A. That is correct. We are talking about the years 1932, 1933, 1934, and 1935, and he continued to be secretary of Panhandle Eastern Pipe Line Company until some time around the directors' meeting of the company held in April, 1935.

Q. That is right.

Now, Mr. Gregory was a director?

A. Mr. Gregory apparently ceased to be a director of Panhandle Eastern Pipe Line Company about April 24, 1935, and was at that time succeeded by Mr. W. P. Phillips.

[fol. 7240] Q. Mr. T. R. Weymouth?

A. Mr. Weymouth was a director of Panhandle Eastern Pipe Line Company for a certain period up to and including April 24, 1935, when, at the directors' meeting held that day, apparently his resignation was acted upon and he was succeeded by Mr. J. L. Harrop.

Q. At that meeting were you elected secretary and treasurer of Panhandle Eastern for the first time?

A. That is correct.

Q. And has there been any officer of Columbia Gas & Electric Corporation on the board of directors of Panhandle Eastern since April of 1935?

A. Mr. Chamberlain, I do not know all of the officers and directors of the Columbia companies, so, please will you tell me who it is you are inquiring about and I shall attempt then to answer? I cannot answer such a general [fol. 7241] question.

Q. You mean that with all of your connections with the Columbia organization, your intimacy with the personnel, that you are unable to tell whether upon the small board of Panhandle Eastern there has been an officer or director of Columbia Gas & Electric Corporation since April of 1935?

A. I mean exactly, sir, that, and I should ask you whether or not you can look back through your memory and tell me specifically who was a director of the United Power & Light Company, I believe it is, the parent of Michigan Consolidated Gas Company, or any of the subsidiaries or parents of that subsidiary, at any specific date certain.

Q. Do you know of any officer or director of Columbia Gas & Electric Corporation who have been an officer or director of Panhandle Eastern since April of 1935?

A. Of either Columbia Gas or Columbia Oil?

[fol. 7242] Q. I said Columbia Gas & Electric Corporation.

A. It would appear, sir, from the information I have before me and subject to my lack of knowledge with respect to some of the individuals that there had been no officer of Columbia Gas & Electric Corporation an officer of Panhandle Eastern Pipe Line Company, nor has there been any director of Columbia Gas & Electric Cor-

poration a director of Panhandle Eastern Pipe Line Company since the date to which you referred.

Q. Did I understand that after your election the office of secretary-treasurer of Columbia Oil you moved to New York?

A. Yes, sir.

Q. And for how long a period did you live there?

A. In New York?

Q. Yes.

A. Well, I live in South Orange, at this very moment.

Q. You are living there still?

A. Oh, yes, yes, but let's be sure that we understand what we mean when we say that. The record will show that during the time that I was an officer of Columbia Oil & Gasoline Corporation I was running around over the country between Kansas City and Charleston and various other points where my duties took me far more than the Watkins family appreciated. Now, then, I am still subject to the necessity of spending a vast amount of my time in Kansas City.

Q. Yes. Now, you became, at that time, the secretary and treasurer of the various operating subsidiaries of Columbia Oil & Gasoline Corporation, did you not?

A. Not treasurer, sir. Secretary and assistant treasurer of the subsidiaries.

Q. I see. And you served in substantially that capacity with respect to the subsidiaries until your resignation from the Columbia Oil organization in 1937?

A. That is correct.

[fol. 7244] Q. And as secretary of Columbia Oil, were you the chief accounting officer?

A. I was, not necessarily because I was secretary, however.

(Interposing). But I was the chief accounting officer.

Q. The by-laws of Panhandle Eastern make you the chief accounting officer, do they not?

A. The by-laws of Panhandle Eastern provide that there is to be a controller and the controller may be the same person as the secretary and the controller is the chief accounting officer.

Q. But, as a matter of fact, you were the chief accounting officer of Columbia Oil during the period of your service with that company? A. That is correct.

Q. You had the custody of the minutes of the Board of Directors of that Company, and also the subsidiaries, did you not? A. I did.

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[fol. 7245] Q. Do you remember where you were on the 6th day of March, 1935?

A. I do not. Does this mass of details show it?

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[fol. 7246] Q. That was the day the Government filed this anti-trust action against Columbia Gas and Columbia Oil, was it not?

A. I do not know.

Q. You do not know about that. You recall, do you not, about the early part of 1935, that the Department of Justice filed an action in equity in the Delaware District in Cause Number 1099, I believe, which was in the nature of an anti-trust action against Columbia?

A. I know there was such action filed. As to the actual date upon which it was filed, I cannot answer.

Q. And do you remember about in July that there was another suit filed by Henry T. Bush and C. Ray Phillips as receivers of Missouri-Kansas Pipe Line Company, against Columbia Oil & Gasoline Corporation and others in the Southern District of New York, United States District Court?

A. I believe there was such a suit filed. I do not know whether it was filed on that day or not. There have been such a vast number of suits filed directly by all of the companies over the period that I have been connected with them that I could not specifically recall the date of such [fol. 7247] suits or the nature of the action.

Q. These two actions are such that you remember them, do you not?

A. I remember, as I have stated in answer to your question, that there was a suit. I remember, likewise, that Messrs. Phillips and Bush, receivers of Missouri-Kansas, probably filed more than one suit. If they are anything like Missouri-Kansas, they surely did.

Q. Now, what other suits did they file?

A. I really do not know.

Q. That is just sort of a guess?

A. Perhaps a guess.

Q. Now, on June 1, 1936 there was an agreement entered into between Columbia Oil—and in this examination may I use the words "Columbia Oil," "Columbia Gas," and "Panhandle Eastern" and "Missouri-Kansas" to represent the four companies, and you will understand them in that way?

A. I shall so understand them and, likewise, use them in that fashion, sir.

Q. Now, on June 1, 1936, was there not an agreement executed between Columbia Oil, Columbia Gas, Panhandle Eastern and Henry T. Bush and C. Ray Phillips, as receivers of Missouri-Kansas Pipe Line Company, which involved a settlement of the various difference that existed between these people?

[fol. 7248] A. There was such an agreement entered into, and we, of Panhandle Eastern, know of it generally as the four party agreement as of June 1, 1936.

If my memory serves me correctly, there was, likewise, a three-party agreement entered into on the same date, whether it be between two of the companies involved in the June 1st, 1936, agreement and the Missouri-Kansas receivers or just who the parties were to the so-called three-party agreement of 1936, my memory is somewhat vague.

Now, as to exactly what the June 1, 1936 three-party or four-party agreements contained, I cannot tell you in very great detail, except this, that I believe you will find by an examination of one or both of those agreements, that they were designed to put in writing certain conclusions tending to dispose of some alleged, real or fancied differences that existed between the parties, part of that time, and did specify certain things to be done by certain of the parties, but you would not ask me to recall each and every thing that they contained, I am sure.

Q. I must ask you if you signed that as secretary of Panhandle Eastern?

A. If the secretary of Panhandle Eastern Pipe Line Company signed it, I surely did, because I was the secretary at that time.

Q. Well, can you refresh your recollection by examining [fol. 7249] the exhibit before you?

A. The signature of Leith V. Watkins was apparently affixed to the document in question in that attestation of the signature of the vice president of Panhandle Eastern Pipe Line Company, who signed it, and that gentleman's name was Mr. James L. Harrop.

Q. And at that time Mr. James L. Harrop was vice president of Columbia Oil & Gasoline Corporation, was he not?

A. I believe he was and your witness was, likewise, secretary-treasurer of Columbia Oil & Gasoline Corporation.

Q. And a director?

A. Correct, and Mr. Harrop was, likewise, a director.

Q. Now, the settlement that was outlined and set out in this agreement was approved by the Board of Directors of Columbia Oil & Gasoline Corporation, was it not?

A. I think it may have been, Mr. Chamberlain. I would assume that naturally, it would have been.

Q. Yes. And it was done at a meeting at which you were present; was it not? A. Beg pardon?

Q. It was done at meetings at which you were present?

A. I would assume that to be the case, because, as I recall, I was present at most of the meetings of the Board of Directors of Columbia Oil & Gasoline Corporation, as long as I was a director of that company.

[fol. 7250] Q. Now, I shall, again, ask you to refresh your recollection, if you do not remember the matters which were settled by that agreement, and ask you if it did not cover a settlement of all claims between Columbia Oil, Columbia Gas, Missouri-Kansas, the National City Company, and Panhandle Eastern with respect to the agreement of September 17, 1930, and the amendment thereto, to which you have referred in your previous testimony?

A. I was hoping certainly that it would do that very thing. That was among its purposes.

[fol. 7255] Q. You and I can not argue law, but I am directing your attention to whether or not Panhandle Eastern released all of these parties from any liability under the contract of September 17, 1930, and I refer you—

A. (Interposing) Did I say that the document I am referring to or, rather, it is the four-party contract of June 1, 1936, did not do that very thing?

Q. Yes, sir, but that is my question, Mr. Watkins.

A. Then I misunderstand your question.

Q. Did it?

A. It did, certainly, if it had any such obligation.

[fol. 7256] Now, this settlement arose out of a longer period of litigation between the two stockholders of Panhandle Eastern, did it not?

A. I think that is correct, sir.

Q. And there passed between these people various charges against each other, and there had been a considerable period of litigation and various cases filed in the court with respect to these charges, had there not?

A. I think there was a lot of such action with respect to those alleged, real or fancied differences or charges, if [fol. 7257] you please.

Q. And these settlements were more particularly of interest to the stockholders than to Panhandle Eastern and, of course, I speak of that only in a financial way, not a business way.

A. Well, I do not believe I would agree entirely with that statement, sir, because Panhandle Eastern has always felt the anxiety of having any alleged, real or fancied difference, whether it be between its stockholders or otherwise, cleared up.

Q. Well, I think you are quite correct, Mr. Watkins, but Panhandle received a substantial benefit resulting from this compromise settlement, did it not?

A. In what way, sir?

[fol. 7258] Q. Well, in the way that you have just indicated.

A. Well, we certainly received some peace of mind, because one of the humps was behind us. We were over that

hill, at least. We have had some others that have crept up since then.

Q. It occurs to me that you have had substantial benefits in the way of aid in your refinancing without any particular expense to Panhandle Eastern. That is true, is it not?

A. I do not know what you mean.

Q. Well, you were recapitalized, were you not, without some 11,000,000 of preferred stock or cash without any expense for broker's commissions, is that not true?

A. Yes, there was no brokerage commission in connection with that.

[fol. 7263] Mr. Watkins, I ask you to examine Exhibit No. 145—

Now, you signed this Registration Statement?

A. In two or three places, yes, sir.

Q. Are you familiar with it?

A. I think I am reasonably familiar with it, yes, sir.

Q. Now, I would like to have you refer to the first paragraph [fol. 7264], graph under "Certain other phases of corporate history" if it is necessary to refresh your recollection and then I want to ask you a question.

A. I have referred to the paragraph, sir.

Q. All right. Is it true that on March 6, 1935, the United States Government instituted an anti-trust suit against Columbia Oil, Columbia Gas & Electric Corporation (hereinafter sometimes called Columbia Gas), George H. Howard, Phillip G. Gossler, Charles A. Munroe, Thomas R. Weymouth, Thomas B. Gregory, Edward Reynolds, Jr., Burt R. Bay, and John H. Hoffman, Jr., alleging, among other things, the defendants had dominated the company for the purpose of preventing competition between The Company and Columbia Gas?

A. Such a suit was filed and the facts you have recited appear as a part of Exhibit No. 145 in these proceedings and your witness is among the officers of Panhandle East-

ern Pipe Line Company who signed that Registration Statement and the facts stated in it are correct.

Q. And it is your understanding that any reference to "The Company" refers to Panhandle Eastern Pipe Line Company?

A. Wherever the words, "The Company" are used in this exhibit, they do refer to Panhandle Eastern.

Q. Yes. Now, is it true that in October, 1935, the Government amended its Bill of Complaint in that suit and [fol. 7265] that the suit was finally terminated by stipulation and consent decree entered January 29, 1936?

A. That is true and it was also true that yesterday was the sixth anniversary of that.

Q. A copy of that decree was appended to your Registration Statement, A-2; was it not, and the stipulation—

A. (Interposing). Well, it was not appended to the stipulation, no, sir.

Q. Filed as an exhibit?

A. I shall refer to the list of exhibits and see whether or not it was incorporated by reference or filed with the exhibit itself.

On Page 95 of Exhibit No. 145, as exhibit K-1, there was incorporated by reference a copy of the stipulation and decree entered January 29, 1936, in Cause No. 1099 In Equity in the District Court of the United States for the District of Delaware, filed as Exhibit I-1 to the company's Registration Statement No. 2-2764.

Q. Now, you have seen the stipulation in that case, have you not, Mr. Watkins?

A. Unfortunately so, sir, I have.

Q. And you would recognize a printed copy of it, would you not?

A. I think I might.

Q. Now, I would like to have you state whether or not [fol. 7266] the stipulation entered in that case, being Equity No. 1099 of the United States District Court, District for Delaware, did not contain the following provisions:

"V(c) — The Defendant, Columbia Oil, agrees to make, within 48 hours of the entry of the attached decree, a bona fide offer in writing to the receivers of Missouri-

Kansas Pipe Line Company, appointed by the Delaware Chancery Court, providing among other things for the settlement of the claims of the receivers, as asserted against the defendant herein and the acquisition by the receivers of a direct interest in the stock of Panhandle Eastern Pipe Line Company, to the extent that one-half of the initial amount of common stock of Panhandle Eastern Pipe Line Company to be outstanding after a recapitalization thereof, subject to any right of preferred stock which may have voting rights and rights of conversion into common stock and also subject to other conditions of the offer which may alter the proportionate interest of the various parties in Panhandle Eastern Pipe Line Company."

[fol. 7270] Q. Now, Mr. Watkins, is it true that on July 18, 1935, Henry T. Bush and C. Ray Phillips, as Receivers of Mo-Kan, instituted a suit for damages against Columbia Gas, Columbia Oil, and certain individual defendants, claiming damages by reason of the alleged domination of the company by these defendants, and the suit was settled on or about April 29, 1936?

[fol. 7271] A. That is correct.

Q. And is it true that copies of the offer of settlement, as extended and modified, and of the acceptance thereof, [by] incorporated by reference as Exhibit K-2, to your registration statement No. 2-4919?

A. That is correct and the registration statement refers to that exhibit for a complete statement of its provisions.

Now, I would like to have a document I now hand the reporter marked for identification with the next number and that there be attached the suffixes "A", "B", and "C" to cover what is in the exhibit named as "Exhibit H-6", "Exhibit H-9", and "Exhibit I-2" the purpose being that I desire to offer them collectively and separately, as well, and, further, that they refer to different matters.

[fol. 7272] Trial Examiner: (Interposing) The folio which you are now discussing will be marked for identification as Exhibit 137 and I understand that it consists of

three parts which you desire now to separately identify as, respectively, A, B, and C?

[fol. 7274] (Exhibits 157-A, 157-B and 157-C marked for identification.)

By Mr. Chamberlain:

Q. I refer you, Mr. Watkins, to Exhibit 157, including the three portions, A, B, and C, and I will ask you if Exhibit 157-A is not a copy of the agreement between Columbia Oil, Columbia Gas, Panhandle Eastern and the two receivers of Mo-Kan as of June 1, 1936?

[fol. 7277] The Witness: The witness has been supplied by Mr. Chamberlain with a file certified to by the Secretary of the Securities and Exchange Commission as being full, true and complete copies of Exhibit H-6, Exhibit H-9, and Exhibit I-2 to the registration statement filed by Panhandle Eastern Pipe Line Company pursuant to the provisions of the Securities Act of 1933 under File No. 2-2764 and in connection with that file, Mr. Chamberlain has offered, if the witness understands the status of the proceedings at the moment, certain portions of that certificate as exhibits Nos. 157-A, B and C.

[fol. 7278] Exhibit No. 157-A for identification was a photostatic negative copy of an agreement dated January 31, 1936, between Panhandle Eastern, Columbia Gas and Columbia Oil. There were no exhibits attached to that agreement.

Exhibit No. 157-B for identification is a photostatic negative copy of an agreement dated as of June 1, 1936, between Columbia Oil, Columbia Gas, Panhandle Eastern and the receivers of Missouri-Kansas Pipe Line Company, to which there were attached certain exhibits.

Exhibit No. 157-C for identification consisted of photostatic negative copies of a letter dated January 31, 1936 from Columbia Oil to the receivers of Mo-Kan, concurred

in by Columbia Gas, as well; the photostatic negative copy of a letter dated March 4, 1936 addressed to Columbia Oil & Gasoline Corporation which was signed by Messrs. Frank P. Parish and Dupuy G. Warrick; as well as a photostatic negative copy of a letter dated March 5, 1936 addressed to Messrs. Frank P. Parish and Dupuy G. Warrick by Columbia Oil & Gasoline Corporation, concurred in by Columbia Gas & Electric Corporation; as well as a photostatic negative copy of a letter dated April 22, 1936 addressed jointly to Columbia Oil and Columbia Gas, the subject of which is shown as "Missouri-Kansas Pipe Line Company receivership," which was signed by Messrs. C. Ray Phillips and Henry T. Bush as receivers of Missouri-Kansas Pipe Line Company, which said letter carries a foot not agreeing to the modifications set forth therein by Columbia Oil and Columbia Gas.

There is a further photostatic negative copy of a letter dated April 29, 1936, addressed jointly to Columbia Gas and Columbia Oil which was signed on behalf of Henry T. Bush and C. Ray Phillips, receivers of Missouri-Kansas Pipe Line Company, by Marvel, Morford, Ward & Logan, their attorneys.

The Witness: This material is certified to, by the Secretary of the Securities and Exchange Commission as being Exhibit H-6, H-9, and I-2, to the registration statement filed with the Securities and Exchange Commission on December 30, 1936, by Panhandle Eastern Pipe Line Company pursuant to the provisions of the Securities Act of 1933, as amended, under File No. 2-2764, and if the witness may speak further, as the respective documents were referred to in identifying them with Exhibit Nos. [fol. 7280] 157-A, B and C for identification, it is his belief that they are true and correct copies of the documents they purport to be.

[fol. 7299] Trial Examiner: The item of going-concern value, as presented by Mr. Biddison, I believe, was disig-

rated "Cost of developing business." May I ask, Mr. Wheat, whether you are in agreement with Commission counsel that the items to which Mr. Chamberlain has referred, aggregating \$5,000,000 or more, may be classed as [fol. 7300] a part of the claim for going-concern value?

Mr. Wheat: We have not so used any such term. We have considered this as a cost in dollars of carrying unused capacity just exactly the same as interest during construction or any of the other costs to which this company was put in bringing its business to a stage of full operation. That is the basis of the claim.

We do not personally feel, on behalf of the company, I think it should be stated again, as it has been stated many times before in this record, that the type of proof which Mr. Chamberlain now suggests is material to that issue. The money unquestionably was spent and there is not even a hint in counsel's statement or in the statement of Commission counsel that the money was not spent.

Trial Examiner: Is there any distinction between the item in this case aggregating \$5,000,000 or more and the item of \$8,500,000 which was designated, as I recall, going concern value in the case of the Natural Gas Pipe Line Company?

Mr. Wheat: I do not know, sir. I think that is a matter that would require very considerable consideration. Mr. Culton is, of course, familiar with the record in that matter.

Mr. Culton: The items are the same. It was referred [fol. 7301] to, as Mr. Biddison stated, in that case as "going concern value," but it is not going concern value in the sense that those words have been used in the former cases. The items are similar.

Trial Examiner: You have covered the point the Examiner had in mind, whether or not the character of the expenditures there characterized as going concern value were similar to the expenditures involved in this aggregate of \$5,000,000.

Mr. Culton: That is right.

Trial Examiner: Proceed, Mr. Chamberlain.

Mr. Chamberlain: The intervener now offers in evidence as a supplement to Exhibit No. 145, introduced by Panhandle Eastern, and particularly with reference to the statements on page 9 thereof, Exhibit 157.

Mr. Wheat: Mr. Examiner, we have no objection, of course, to any data which this company has filed with the Securities and Exchange Commission being made a part of this record on any basis or principle. We think, however, that we are encumbering the record, commencing, at least, the encumbrance of the record with what probably will become a very large encumbrance before we are through and it is, to a great degree, immaterial.

This witness, of course, can be asked to identify large numbers of documents. We understood the witness was under cross examination.

[fol. 7302] I offer this statement merely to show that we have no desire to have this record encumbered with tonnage.

[fol. 7304] Mr. Chamberlain: I am sure that there is a reasonable informality in these proceedings but perhaps I should, as a matter of caution, ask that the record show that I have offered Exhibit No. 157-A, 157-B and 157-C, separately. That is, the ruling is to be deferred and I have no objection to that but I would like the record to show that I offered them separately.

Trial Examiner: Very well, they will be so treated.

Q. Now, Mr. Watkins, getting back to our questions on page 9, I wish to ask you whether the suit of Henry T. Bush and C. Bay Phillips of Mo-Kan against Columbia Oil and others on July 18, 1935, was still pending at the time of the signing of the stipulation and decree in the antitrust [fol. 7305] action, to wit, January 29, 1936?

A. It was and this witness had testified previously that it was not settled until April 29, 1936.

Q. And that included at least claims of the receivers which had been asserted against Columbia Oil prior to January 29, 1936, did it not?

A. I suppose it did.

Q. Just one more question as to the pendency of the antitrust action. A supplemental complaint was filed by the United States Government on or about December 21, 1938, was it not?

A. In connection with the so-called antitrust suits to which reference has been made?

Q. Yes.

A. That is correct.

Q. And it is still pending at this time?

A. That is correct.

[fol. 7306] Mr. Chamberlain: Of course, you are stating something that refers to peak loads, not to sales of gas. The company has ample gas for sale and I understand it is desirous of selling it.

By Mr. Chamberlain:

Q. I am referring you to the middle paragraph on page 10 for one question. Is it not a fact that the amended and supplemental complaint of the Government in the antitrust action alleges that the decree of January 29, 1936 failed to nullify elements of control over the company by Columbia Gas which existed at the time of entry of such decree, that the company has been precluded from engaging in commerce in natural gas and from competing in any manner with Columbia Gas and Columbia Oil in the States of Indiana, Michigan and Ohio, and that the acquisition of [fol. 7307] the capital stock of Michigan Gas Transmission Corporation by Columbia Gas has had the effect of restraining commerce in natural gas in said States and of tending to create therein a monopoly in natural gas?"

A. Yes, I believe it is quite correct that the amended and supplemental complaint does contain such allegations but, by virtue of the mere fact of furnishing such information in a registration statement, neither Panhandle Eastern Pipe Line Company nor any of its officers or directors admitted that those facts were correct.

The purpose of supplying this information is responsive to the requirements of the rules and regulations governing the preparation and submission of a registration statement.

[fol. 7310] Q. Now, I direct your attention, Mr. Watkins, to the contract of September 17, 1930, to which you have made a very considerable number of references. Do you have with you a copy of that contract?

A. I have.

Q. Will you get it before you? Did that contract contain a provision to the effect that Missouri-Kansas Pipe Line Company, either directly or through its present and/or future subsidiaries, will enter into gas purchase contracts with the Panhandle Company upon substantially the following terms:

[fol. 7311] Q. (Continuing) "1. An excess capacity contract for the purchase up to 20,000,000 cubic feet of gas per day at 18 cents per m. cubic feet, without limit as to time so long as the Panhandle Company has any excess capacity, provided that if the Panhandle Company can sell all or any gas at a higher price it may reduce proportionately deliveries under this excess capacity contract.

2. Firm contract, commencing when the Panhandle Company gives notice to the Pipe Line Company and Columbia that it no longer has any excess capacity, for ten years and thereafter with right of cancellation by either party on one year's notice, at the rate of 26½ cents per m. cubic feet, deliveries under such contract to be as required by the Pipe Line Company and to aggregate for each year an amount producing at least a 70 percent annual load factor based on the maximum daily delivery, [fol. 7312] which maximum shall in no case exceed 20,000,000 cubic feet per day, and after the expiration of one year from the effective date of this firm contract such maximum day shall not exceed the maximum day established during said first year."

A. The contract of September 17, 1930, does have the provisions which counsel has just read, and it might be of interest to observe in connection with those provisions that it is the witness' belief that United Light & Power Company had something to do, perhaps a good deal to do, with the fact that the contracts referred to in this particular section of the September 17, 1930, contract were not actually executed.

[fol. 7314] Q. Now, let me ask you, Mr. Watkins, whether the contract of September 17, 1930, contains a somewhat similar provision with respect to the contract for the sale of gas to Columbia Gas & Electric Corporation, and, if so, will you read into the record that provision?

A. There is, apparently, a similar provision with respect to Columbia Gas & Electric Corporation included in that contract which appears at V-(c) and is as follows:

[fol. 7315] "(c) That it will cause the Columbia Gas & Electric Corporation, either directly or through its present and/or future subsidiaries, to enter into gas purchase contracts with the Panhandle Company at or near the Indiana-Illinois State Line upon substantially the following terms:

"(1). An excess capacity contract for the purchase up to 20,000,000 cubic feet of gas per day at 18 cents per m. [fol. 7316] cubic feet, without limit as to time so long as the Panhandle Company has any excess capacity, provided, that if the Panhandle Company can sell all or any gas at a higher price it may reduce proportionately deliveries under this excess capacity contract.

"(2). Firm contract, commencing when the Panhandle Company gives notice to the Pipe Line Company and Columbia that it no longer has any excess capacity, for ten years and thereafter with right of cancellation by either party on one year's notice, at the rate of 26½ cents per m. cubic feet, deliveries under such contract to be as required by Columbia and to aggregate for each year an amount producing at least a 70 per cent annual load factor based on the maximum daily delivery, which maximum shall in no case exceed 30,000,000 cubic feet per day, and after the expiration of one year from the effective date of this firm contract such maximum day shall not exceed the maximum day established during said first year."

[fol. 7317] Q. Now, before leaving this contract, I wish to call your attention to Article VIII, particularly with respect to the gas sales and purchase contracts which are now carried on the books of Panhandle Eastern Pipe

Line Company, and I would like to have you read into the record Paragraph VIII.

The Witness. "The price per share for the stock of Panhandle to be sold by the Pipe Line Company and to be purchased by Columbia under the provisions of this contract shall be ascertained as follows: There shall be determined [fol. 7318] by Arthur Anderson & Co. the actual cash investment as of August 31, 1930, of the Pipe Line Company system in the Panhandle Company and the Panhandle's subsidiary companies as the subsidiaries now exist, such cash investment to be the actual original cash cost to the Pipe Line Company system, plus interest thereon during construction at the rate of six per cent per annum, and such cash cost to include the payments made for engineering services by others than companies affiliated with the Pipe Line Company system, legal expenses, taxes during construction, organization costs, costs of franchises, and the \$631,000 expended by the Panhandle Company for gas sale or gas purchase contracts. To such aggregate cash investment shall be added the debts and obligations existing at the Panhandle Company and its subsidiaries on August 31, 1930, to be paid by the Pipe Line Company as per Article IV paragraph (c) above (these debts and obligations not to include those of the subsidiaries of the Pipe Line Company whose stock is to be transferred to the Panhandle Company as per said Article IV paragraph (c)). To the sum so ascertained shall be added \$7,333,000. This price per share of Panhandle stock shall be obtained [fol. 7319] by dividing the total sum by 10,000 and adding interest on said price at the rate of six per cent per annum from August 31, 1930, to the date of payment for each share of stock."

[fol. 7320] By Mr. Chamberlain:

Q. Do you have with you a copy of the supplemental agreement between the parties, of date October 23, 1930?

A. Yes, sir; I have it.

Q. Well, I would like to have you read into the record the first and second paragraphs in that they relate to the facts stated in the Article VIII of the original contract.

A. The first and second paragraphs of the memorandum of agreement dated October 23, 1930, to which counsel has referred, are as follows:

"First: In adjustment of a dispute existing between [fol. 7321] the parties, as to the amount required to be paid by the Oil Company under the contract for said shares of Panhandle stock, it is agreed that the computation of the purchase price per share of Panhandle stock to be purchased by Columbia is to be computed exactly as set out in Article VIII of the contract, except that the figure of \$7,333,000 therein mentioned shall be reduced to \$6,453,000 and the computation of interest therein provided for shall be correspondingly adjusted. The purchase price per share of Panhandle stock to be paid by Columbia as of the date hereof, before calculating interest from August 31, 1930, is accordingly \$1,938.58 2/3."

"Second: The book value of the property to be transferred by Missouri-Kansas to Panhandle, according to Article IV (a) of the contract shall be not less at the closing date than on August 31, 1930, without revaluation of any of the items. Under date of October 22, 1930, Arthur Anderson & Co. advised Columbia and Missouri-Kansas that the book value of the items referred to, exclusive of investments, was as follows:"

There then follows a table under two general headings, the first of which is: "Particulars", and the second of which is: "August 31, 1930."

[fol. 7322] I shall first read the "Particulars" and then the amounts shown in the column headed "August 31, 1930."

The statement under the heading "Particulars" is as follows:

"Book value of assets to be transferred by Missouri-Kansas Pipe Line Company to Panhandle Eastern Pipe Line Company (paragraph (a) Article IV.):

"Gas purchase and sales contracts—stated at valuation determined by Messrs. Brokaw, Dixon Garner & McKee, Geologists and Petroleum Engineers, and approved by Board of Directors: \$1,106,250.00

"Pipe lines, compressors, etc. exclusive of Kentucky Division properties: 2,417,948.52"

"Prepaid accounts: 3,565.19"

"Materials and supplies at book values: 46,140.41."

Paragraph Second continues as follows:

"They further state, with reference thereto, as follows:

"The book values of the properties located in Kentucky and Southern Indiana have been determined as accurately as was possible in the time available, as noted above, the book value of the Kentucky Division properties has been excluded in the foregoing tabulation at both dates."

Q. Now, in your testimony yesterday you referred to [fol. 7323] certain items on the books of Panhandle Eastern, which reflected the cost of the purchase of these gas contracts, did you not?

A. Well, this witness is not at all sure that Panhandle Eastern may have received all the gas sale and purchase contracts that Missouri-Kansas had at August 31, 1930. It may have had some that were not even on its books.

Q. All right, will you please turn to Article IV of the contract of September 17, 1930, and read into the record the beginning of that paragraph down to the end of Paragraph (a)?

A. Article IV of the September 17, 1930 contract is as follows:

"IV. The Pipe Line Company agrees with the parties hereto as follows:

"(a) That it will transfer to the Panhandle Company all [fol. 7324] of the natural gas fields, gas contracts, pipe lines, distributing systems, etc. which it owns wherever located, except those located in Kentucky [of] Southern Indiana, and its stock ownership in all corporations which may own similar property located in the same territory."

Does that complete your question?

Q. Yes. Your agreement covered all that it had, did it not?

A. This agreement did. My answer to your previous question was that this witness had no knowledge that Missouri-Kansas actually transferred all of the things that have now been referred to in this Article IV, which has just been read into the record:

[fol. 7327] Q. Please refer, Mr. Watkins, to Article VIII of the contract of September 17, 1930, and to the statement that there is included the \$631,000 expended by the Panhandle Company for gas sale or gas purchase contracts.

Now, what was on the books of Panhandle Eastern as of August 30, 1930? Let us have the—

Items as to the cost of gas sale or gas purchase contracts.

A. I cannot answer that question other than in this manner, the analysis that I have with me of the value of gas sales and purchase contracts for the books of Panhandle Eastern Pipe Line Company speaks of an amount as of April 30, 1932. There was, however, an entry made in 1930 which included a total of \$642,286.30. It is my present belief that that amount is substantially the amount referred to by you in Article VIII of the September 17, 1930, contract.

Q. That is the amount named in that contract with the addition of your miscellaneous expense of \$11,286.30, isn't it?

A. The miscellaneous expense, to which this witness has testified, was a total of \$12,703.04. Without further investigation, sir, I could not reconcile the difference between \$631,000, as shown in Paragraph VIII of the September 17, 1930, contract, and the amount included in [fol. 7328] my analysis, other than to say this: that at August 31, 1930, the books of Missouri-Kansas Pipe Line Company or Panhandle Eastern Pipe Line Company were not exactly current. That is not a reflection on the employees responsible for the maintenance of those books or records, nor of the officers or directors of those companies. The companies were engaged in a very extensive construction program and were in the process of spend-

ing some \$40,000,000. Their records were not quite up to date at the time this September 17, 1930, contract was entered into or, for that matter, at the time it was consummated, or, for that matter, they were not quite in as complete a state as they should have been when I appeared on the scene somewhat more than a year later.

That does not impeach the record; if you please, sir, that is simply my way of explaining the difference here.

Q. If I have the figures which you gave yesterday correct, you gave three items which would amount to exactly that \$631,000. Now, see whether I have this correctly. In May, 1930, did you not mention a five-year six percent note issued to F. R. Parish & Company in payment for the 15,000 shares of Missouri-Kansas stock at \$28 per share for use in connection with obtaining gas sales contracts with Illinois Power & Light Corporation and Missouri Power & Light Company, \$420,000? [fol. 7329] A. I did.

Q. Now, did you not then have one in June of 1930 of a seven per cent note to the same company in payment of 4,000 shares at \$34 per share in connection with gas sales contracts, of a total of \$136,000? A. I did.

Q. And did you not have an item in June of 1930, payment to American Coke & Chemical Contracting Company for industrial contracts in Peoria, \$75,000?

A. I do not know, sir, that I stated that that was in June, but there was such an amount and was paid to the American Coke & Chemical Contracting Company.

Q. And my information leads me to believe that in [fol. 7339] your registration statement you have reported those payments as having been made by Panhandle Eastern in May and June of 1930 and, if so, that would account for the \$631,000 mentioned in Paragraph VIII of the contract of September 17, 1930.

A. Well, they do account for the \$631,000 mentioned there. If we are particularly interested in the dates, I shall try to ascertain them.

Q. No, I just wanted to know that they were before the date of the contract at all, except that it is before.

A. Oh, it is before.

[fol. 7331] Q. Now, have you made any search to find the valuation that was placed on the gas purchase and gas sales contracts of Missouri-Kansas by Brokaw, Dixon, Garner & McKee prior to the September 17, 1930, contract?

A. I have not. Now, let me see, please, if I understand your question. You are asking the witness whether or not the witness has made any search to ascertain the [fol. 7332] fact that there was such a valuation made by that firm?

Q. Yes.

A. As far as I recall, I have never seen a copy of such valuation. It could be that I am wrong.

Q. This is the same firm of engineers who appraised the cash contracts at around \$11,000,000, is it not?

A. That is correct, and, also, the same firm of engineers that had to do with the original construction of Panhandle Eastern properties and did a good job.

[fol. 7337] Q. Now, as secretary of Panhandle Eastern, you are the custodian of the minutes of its Board of Directors? A. I am.

Q. And they are presently in your custody?

A. At this moment, no, sir. When I am in the office they are, sir. When I am away from the office, they are locked in the vault and my secretary has the key to it, yes, sir.

[fol. 7339] Q. Will you please refer to page 888 of Document 92, Part 82 of the Report from the Chairman of the Federal Trade Commission, in response to Senate Resolution No. 83 of the 70th Congress?

With the agreement that this is subject to correction after an opportunity to compare with the original records, I would like to ask you as to the contents of the minutes of a special meeting of the Board of Directors of Panhandle Eastern, held at 61 Broadway, New York, on Tuesday, May 26, 1931,—first, who was present at the meeting?

A. According to this exhibit there was present Messrs. F. W. Crawford, F. T. DuPont, T. B. Gregory, W. G. Ma-

guire, C. A. Munroe, F. P. Perry and S. A. Russell.

[fol. 7340] Q. Now, was counsel also present?

A. There was also present Mr. E. C. Bailey of counsel for the company and Mr. Ralph Shaw, who accompanied Mr. Perry.

Q. And did the secretary, Mr. E. Reynolds, preside?

A. No, sir, he acted as secretary of the meeting.

Q. I am sorry, I meant as secretary. Now, I would like to have you read into the record a statement made by Mr. Parish with respect to the management which you will find beginning at the bottom of page 889?

* * * * *

[fol. 7341] Q. I would like to have you read from the record of the minutes of the Board of Directors as of this date beginning with the words "Mr. Parish stated that he considered"—which you will find near the bottom of page 889, and to read down to the last paragraph of page 890.

A. Down to the last paragraph?

Q. Yes, sir, of Document 82, Part 92.

A. "Mr. Parish stated that he considered that one of the most important matters before the management at the present time was the insuring of the sale of the company's gas production, and that in this connection he requested a statement from the management as to the efforts being made toward that end and offered certain resolutions instructing the officers of the company to proceed with the preparation and execution of the contracts with [fol. 7342] Missouri-Kansas Pipe Line Company, and with the Columbia interests called for by the Agreement of September 17, 1930, between the Missouri-Kansas Pipe Line Company, the National City Company and Columbia Oil & Gasoline Corporation; which resolutions he requested the secretary to read.

After reading the same, the secretary stated that the officers of the Company had had the form of such contracts under consideration for some time, but that it had not been thought necessary to press the matter since the pipe line would not be ready to deliver gas for several months.

"The president then made the following statement:

"The Panhandle Eastern Pipe Line Company has made or has under consideration various contracts for the sale of gas to other companies, each for their requirements in certain specified quantities and territories.

"Among such proposed gas sales contracts are those under which Columbia Gas & Electric Corporation and Missouri-Kansas Pipe Line Company would be entitled to call on the Panhandle Eastern Pipe Line Company to supply them with gas.

[fol. 7343] "It was definitely agreed that any gas to be taken under such contract by Columbia Gas & Electric Corporation would be for supplying Indianapolis and northern Indiana territory, extending to Detroit and other points in Michigan and connecting with existing pipe lines in Ohio.

"It was, likewise, definitely agreed that any gas to be taken under such contract by the Missouri-Kansas Pipe Line Company would be only for the purpose of supplying gas to the southwestern parts of Indiana through Terre Haute, and south to Nashville, Tennessee.

"The Panhandle Eastern Pipe Line Company hereby notifies Columbia Gas & Electric Corporation and Missouri-Kansas Pipe Line Company that it does not consider that either of them would be entitled to gas under such contract, if the gas so supplied is to be used in violation of the above agreements or for the purpose of interfering with the distribution of gas by the other party."

"Considerable discussion between various members of the Board followed, with reference to certain parts of the negotiations leading up to said contract of September 17, 1930, and developments thereafter bearing on the use of gas to be delivered by Panhandle Eastern Pipe Line Company under the agreements provided for therein.

"During this discussion Mr. Parish renewed his motion that his resolutions be adopted and there was a delay of a few minutes while several members read the resolutions in detail. Mr. Munroe then stated that he did not see any particular objections to the adoption of the resolutions or the making of the contracts with Missouri-Kansas and Co.

lumbia Gas & Electric contemplated by them, but he wanted it distinctly understood that those contracts should definitely provide that none of the gas taken by Missouri-Kansas should be supplied in the Indianapolis market because that would be a violation of the agreement to take such gas for the purpose of supplying southern and southwestern Indiana and southward including Nashville, Tennessee. Mr. Gregory suggested that that statement be amended or supplemented by the statement that the Panhandle would sell gas to the Columbia Oil & Gasoline Corporation for distribution in the Indianapolis market because that was in accordance with the agreements on which such contracts would be based.

"The proposed resolutions were thereupon laid on the table without being voted upon."

[fol. 7351] LEITH V. WATKINS a witness, having been previously duly sworn, resumed the stand and testified further as follows:

Mr. Gorman: Mr. Watkins, at Lines 21 to 25 on Page 7092 of the hearing transcript of January 29, during the course of cross-examination by me, you made the following response to a question:

"Are you conscious of the fact that with respect to the gas sales and purchase contracts following some of the transactions that were consummated in the early part of 1936, perhaps as of December 31, 1935, some \$600,000-odd of the original \$3,053,391.53 was written off the reserves?"

Now, I understand that you have some correction to make with respect to that statement and similar statements which follow in the transcript. Is that correct?

The Witness: That is correct, sir. The actual facts were that the \$3,053,391.53, as shown on Page No. 2 of Exhibit No. 52 in Column G on Line 40, was reduced by \$123,105.13 as shown on Line 42 on the same page in the same column and that thereafter, the amount became \$2,930,286.40 as shown on Line 40, Page 2, Exhibit No. 52, and

that the inference made by the witness previously that the [fol. 7352] difference between \$123,105.13 and \$600,000-odd was in some manner taken from the records was incorrect.

Mr. Gorman: Yes, and the result of your statement is that the \$642,000-odd was originally contained in the \$3,053,000-odd and from your present information, you do not know exactly what portion of that \$642,000-odd was retired by the reduction of \$123,105.13 to which you have made reference?

The Witness: Let's put it this way, Mr. Gorman, if we may:

The \$123,105.13 reduction was not necessarily applicable to any individual element of the \$600,000-odd. It was applied to the sum total.

[fol. 7353] Q. Mr. Watkins, I call your attention to the minutes of an adjourned meeting of the Board of Directors of Panhandle Eastern held at 61 Broadway, New York, on Friday, June 5, 1931.

Mr. Wheat: Mr. Chamberlain, these questions are asked at this time with the understanding that the witness may check against the original records.

Mr. Chamberlain: Yes, certainly.

[fol. 7354] By Mr. Chamberlain:

Q. Who were present at the meeting?

A. Messrs. F. W. Crawford, F. I. DuPont, T. B. Gregory, G. H. Howard, W. G. Maguire, C. A. Munroe, F. P. Parish, E. Reynolds, Jr., and S. A. Russell.

There were also present, by invitation, Messrs. E. C. Bailly, D. M. Moffat, Ralph Shaw, Ralph B. Mayo, Boykin Wright, B. R. Bay and L. A. Seyffert.

Q. Mr. Crawford presided, did he, and Mr. Reynolds acted as Secretary?

A. That is correct, sir.

Q. I would like to have you read into the record that part of it covering the last two or three paragraphs, beginning at the words "Mr. Parish then requested".

Mr. Chamberlain: Page 896.

The Witness: (Reading) "Mr. Parish then requested that further consideration should be given to the subject matter of the resolutions which he proposed at the previous session of the meeting, held May 26, 1931, and which had been laid on the table. Mr. Munroe then offered the following resolution as a substitute for the same:

"Resolved, That the officers and counsel of this company be, and they hereby are, instructed to prepare and submit to this board, for approval, a form of contract for [fol. 7355] the purchase from this company by Missouri-Kansas Pipe Line Company, of gas in accordance with the agreement between Missouri-Kansas Pipe Line Company, the National City Company, and Columbia Oil & Gasoline Corporation."

"Mr. Munroe's motion was seconded by Mr. Gregory and after discussion it was put to vote and unanimously adopted.

"Mr. Munroe then moved and Mr. Gregory seconded the following:

"Resolved, That the officers and counsel of this company be, and they hereby are, instructed to prepare and submit to this board, for approval, a form of contract for the purchase from this company by the Columbia interests of gas in accordance with the agreement between Missouri-Kansas Pipe Line Company, the National City Company, and Columbia Oil & Gasoline Corporation."

"Upon vote this resolution was also passed unanimously."

Q. Will you refer to the minutes of a special meeting of the Board of Directors of Panhandle Eastern, held at 61 Broadway, New York, on Thursday, July 16, 1931, and first state who were present at that meeting?

A. There were present Messrs. F. W. Crawford, F. I. Du Pont, T. B. Gregory, G. H. Howard, W. G. Maguire, C. A. Munroe, F. P. Parish, E. Reynolds, Jr., and S. A. Russell, who were Directors.

[fol. 7356] There were also present, by invitation of the Board, Messrs. R. B. Mayo, R. M. Shaw, D. M. Moffat, and E. C. Bailly.

Q. I would like to have you read into the record from the minutes of that meeting the five paragraphs beginning with and following the words, "The president then stated [fol. 7357] that he wished to bring up for the consideration of the board the proposed contract between Panhandle Illinois Pipe Line Company and the local utility serving Lincoln, Illinois".

A. (Reading) "The president then stated that he wished to bring up for the consideration of the board the proposed contract between Panhandle Illinois Pipe Line Company and the local utility serving Lincoln, Illinois, in anticipation of which the construction of the lateral line to Lincoln had been embraced in the original project. During discussion of this matter, Mr. Munroe stated that he felt that consideration of this or any such contract was related to the preparation of contracts for the sale of natural gas at or near the Illinois-Indiana State line to Columbia Gas & Electric Corporation and Missouri-Kansas Pipe Line Company, and with the permission of the chairman, proceeded with discussion of the latter subject. He stated that the officers and counsel, pursuant to the resolution adopted by this board at its meeting held on June 5, 1931, had continued actively at work on the preparation of such contracts, in connection with which it had become necessary to make careful estimates to determine the extent to which this company could obligate itself to make deliveries of gas under such contracts in view of its existing obligations.

"He further stated that the figures which had recently been brought to his attention indicated the possibility of [fol. 7358] demands for gas from the Panhandle Eastern Pipe Line in excess of its available capacity without the expenditure of substantial additional sums for additional compressor capacity and perhaps pipe-line capacity. He therefore recommended that immediate, careful, and complete study of the entire situation involving the gas resources, line capacities, and market requirements of Panhandle Eastern Pipe Line Company, together with

determination by counsel of the obligation and responsibility of the company for deliveries under its present contracts, if demanded in excess of pipe line capacities, be made, as he felt that the board heretofore had not been in possession of sufficient facts adequately to realize the possible extent of the commitments which might already have been incurred by the gas sales contracts heretofore authorized and executed, to say nothing of what might be incurred by the conclusion of further gas sales contracts.

To this end he recommended that a committee, composed of a representative of each of the stockholders of Panhandle Eastern Pipe Line Company, be appointed to investigate and make a report regarding the expected sales and earnings and possible additional investment required on the part of Panhandle Eastern Pipe Line Company, and that in case they could not agree as to such expectations, they should be given authority to employ such independent parties as they desire to assist them and that it was his thought that this information should be made [fol. 7359] available with all possible speed.

Mr. Russell, in the discussion, said that he had recently been considering the advisability of having just such an examination made and suggested the advisability that Ford, Bacon & Davis, Inc., or some such firm of standing, be employed for the purpose, but Mr. Munroe expressed the belief that economy in time and cost would result from having the work started by members of the Columbia and Missouri-Kansas organizations, who might call in Ford, Bacon & Davis or other qualified advisers, if necessary, to bring them into agreement.

Thereupon, after further discussion, on motion of Mr. Russell, duly seconded by Mr. Gregory and unanimously carried, Messrs. R. H. Delafield and R. B. Mayo were appointed a special committee to investigate and report to this board the facts regarding the expected sales and earnings of the pipe line west of Indiana, the additional investment required to produce such earnings, and any other relevant facts which would be helpful in preparing the contracts for the sale of gas at the Illinois-Indiana State line, with authority, if the members of said committee were unable to agree, to employ independent

examiners properly qualified to assist them in ascertaining the necessary facts. In connection with the appointment of this committee, the officers of the company were directed to obtain a report from counsel as to the obligations and responsibility for deliveries under the present gas sale contracts of the company and its subsidiaries in case deliveries should be demanded under such contracts in excess of the present or future pipe-line capacities."

Q. Please refer to the special meeting of the Board of Directors of Panhandle Eastern Pipe Line Company held at 61 Broadway, New York, on Thursday, August 13, 1931, and state who were present at that meeting and who presided.

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Trial Examiner: (Interposing) That is not necessary if you identify the source, because we have clearly in the record, the understanding this is taken subject to correction of the original.

[fol. 7361] Mr. Chamberlain: May we have this understanding, then, that all of the testimony given by the witness today with respect to the minutes of the meetings of the Board of Directors of Panhandle Eastern will be read from Document 92, Part 82, of the Federal Trade Commission in response to the Senate Resolution No. 83, 70th Congress.

Trial Examiner: That is sufficient.

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The Witness: The Directors present at that meeting were Messrs. Fred W. Crawford, F. I. DuPont, Thomas B. Gregory, W. G. Maguire, Charles A. Munroe, Frank P. [fol. 7362] Parish and Edward Reynolds, Jr.

Q. I would like to have you read into the record that portion of the minutes of this meeting beginning with the paragraph after that paragraph noting that the minutes of the last preceding [—] of the Board were approved.

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"The chairman then read to the board a copy of a letter from Mr. F. P. Parish to Mr. B. R. Bay, dated August

7, 1931, in which criticism was made of the diligence with which the management of Panhandle Eastern Pipe Line Company was executing its responsibilities.

[fol. 7363] "Mr. Crawford said that he had been advised that a representative of Missouri-Kansas Pipe Line Company had made certain statements indicating that that company was dissatisfied with Mr. Crawford's discharge of his duties as president of Panhandle Eastern Pipe Line Company and felt that on account of his position as an officer and director of the Columbia companies he was not giving his undivided interest and attention to the Panhandle project. Mr. Crawford stated that he had given his entire time and attention to the Panhandle project, to the very great neglect of his Columbia interests, but that he did not care to continue in office if the feeling of the Missouri-Kansas Pipe Line organization was as stated above, and that he wished the representatives of that company on this board to express themselves on this point and wanted to know if such statements had originated with Mr. Parish.

"Mr. Parish denied having expressed any such feeling or ever having heard it mentioned, and Mr. Maguire said that this was the first time he had ever heard such a feeling mentioned. Mr. Parish further said that he was entirely satisfied to have Mr. Crawford continue as president of Panhandle Eastern Pipe Line Company and that he did not think it was necessary for Mr. Crawford to resign from this position or any position in Columbia or from any other position he might hold.

[fol. 7364] "Mr. Parish then said that he still felt that there had been a great deal of delay in effecting arrangements for additional sales of gas by the Panhandle Line, and that he felt more would have been accomplished if more diligent efforts had been made to add load to the line.

"There was then a general discussion of the availability of additional gas for sale under contracts for firm delivery and with particular reference to the ability of the Panhandle Line to commit itself to the proposed contracts with Missouri-Kansas and Columbia interests, and as to progress made by the committee appointed by the board at its last meeting to investigate the entire situation.

Mr. Munroe said that Mr. Mayo had been furnished with all information made available from the Kansas City office of Panhandle Eastern Pipe Line Company, but that there had been so much criticism and suggestion to the effect that the Columbia organization was attempting to color such statements that he wanted it to be made clearly understood that the Columbia organization does not take any responsibility for or express any satisfaction or agreement with such statements furnished to Mr. Mayo; and he said that furthermore the Columbia organization wished the matter taken out of the hands of the said committee, inasmuch as they did not want Mr. Delafield or any other member of the Columbia organization to be subjected to [fol. 7365] the continuation of such criticisms. He and Mr. Gregory recommended the immediate selection of an independent engineer to undertake the investigation in accordance with the discussion held at the last preceding meeting. He quoted remarks made by Mr. Shaw to Mr. P. D. Cravath, counsel for Columbia, charging unnecessary delay in this matter on the part of the Columbia organization.

Mr. Munroe made it clear that neither he nor any other representative of the Columbia interests had ever said that Panhandle Eastern Pipe Line Company would not sell gas to Missouri-Kansas, but that he did say that representatives of the Columbia interests had expressed grave doubt as to the advisability of the Panhandle management committing the Panhandle line to deliver firm gas in the quantities and for the periods contemplated in the proposed contracts with the Columbia and Missouri-Kansas interests.

Mr. Munroe reiterated that the purpose of the investigation was to determine the facts as to the ability of the Panhandle line to live up to its present commitments to deliver gas and to make additional firm commitments, because the information so far furnished him (in respect to which neither he nor any member of the Columbia organization took any responsibility) indicated the possibility that under its contracts already executed the Panhandle line might be called on as early as 1934 for deliveries in excess of its present pipe-line capacity, without considering any deliveries at the Indiana-Illinois State

[fol. 7366] line. He said that obviously an increase in the present capacity would require further capital expenditures and he wanted the investigation to determine the extent of the provisions necessary to be made, so that this board could consider means of obtaining the necessary funds.

Mr. Gregory and Mr. Munroe stated that the successful development of the markets available to the eastern end of the Panhandle line could only be accomplished by the most complete cooperation of all the parties interested and that the present conflict between the stockholding interests in the Panhandle Pipe Line Company was effectively preventing such cooperation and that the reasons for such conflict must be eliminated immediately.

"It was finally decided that the existing committee, consisting of Messrs. Delafield and Mayo, should agree as soon as possible on the employment of an independent engineer to investigate and report to the board the facts of the situation in accordance with the instructions to such committee given by the board at its last meeting held on July 16, 1931."

[fol. 7369] Q. Mr. Watkins, however, you were remarking on one thing that rather fits into the statement of Mr. Gregory at the meeting of August 13, 1931, as to the conflict between the stockholding interests and I would like you to elaborate a little in the record on the information that you indicated that you had received and the actual situation at that time.

A. The witness was about to volunteer, sir, the warning. I suppose one would consider it, which was given to him before he even put his foot in the office of Pan-
[fol. 7370] handle Eastern Pipe Line Company.

Mr. Wheat: Would you mind identifying the place and the time?

The Witness: As far as I remember, Mr. Wheat, it was on a train on the Pennsylvania Lines en route from Dayton, Ohio, to St. Louis, Missouri, about November 16, 1931.

I was being admonished and warned to the general effect that I was about to become identified, temporarily or permanently, with a situation where there was a conflict between stockholders.

Mr. Wheat: And who do you refer to, as the person who admonished you?

The Witness: Mr. F. R. Flahive. Mr. Flahive's words were about like this:

"Now, Keith, the one thing that will cause you to lose your position quicker than anything else is for you to show the least favoritism in any manner, directly or indirectly, with respect to either of the stockholders and particularly with respect to the Columbia Oil side of the thing."

And that, sir is the feeling that was present to me in any contact that I may have had during the entire ten years I have been connected with Panhandle Eastern Pipe Line Company with the so-called Columbia interests.

I had during those years up to and including about the [fol. 7371] year 1936 or 1937, very little contact with anyone having any connection with the Missouri side of the affair but I believe had I had any such contact with that side and had they felt it necessary to make any statements to me, their warning or admonition would have been even stronger than that received from Mr. Flahive.

At any rate, it has been my observation that those of us connected with the affairs of Panhandle Eastern Pipe Line Company have made a most desperate effort to stay in the middle of the road and conduct its affairs purely on the basis of Panhandle Eastern Pipe Line Company without regard to what we might surmise might be the wishes of any stockholder and that is what we are doing at this very moment, sir.

Q. Do you mean that conflict is still continuing?

A. I would not know exactly as to the conflict that might have existed at that time. You remember, of course, that I was a stranger to the operations and knew very little about who the stockholders were.

I would not say it has continued to this date in exactly that manner or whether or not it continues. My statement to

the effect that we are doing exactly the middle-of-the-road job now had nothing whatever to do or any connection with any proposed difference, real or fancied, between stock-[fol. 7372] holders but that is the position that officers and employees of a company should take in any event, whether there be differences or not.

Q. There was a real conflict up to the settlement in 1936, was there not, a continuous conflict between the two interests of the company?

A. You may know more about that than I do, Mr. Chamberlain. I think the records generally of some of our courts, commissions and so forth do show that there has been some squabbling between those stockholders over a rather long period of time.

Q. Mr. Watkins, you must know much more about it than I know about it. Let me call your attention to various things:

You went into Columbia Oil in June, 1934, did you not?

A. I did.

Q. And Columbia Oil was at least a stockholder owning one-half interest at that time?

Mr. Wheat: In what?

Mr. Chamberlain: In Panhandle Eastern.

The Witness: Yes, it was.

By Mr. Chamberlain:

Q. And it owned all of the bonded indebtedness?

A. As of what date, sir?

Q. 1934.

[fol. 7375] Q. Well, you knew that they were working in the Columbia Oil offices with respect to the hearings in Delaware in 1934, did you not, and that they had attorneys and witnesses there for many weeks?

[fol. 7376] A. Who do you mean by "they"?

Q. Columbia Oil and Columbia Gas.

A. Well, I suppose they did.

Q. You knew that they had made an offer to the receivers, did you not, to—

A. (Interposing) Mr. Chamberlain, you keep saying "they", sir. I have stated before that I am not sure that that offer was made by Panhandle Eastern or was made by Columbia Oil.

Q. I do not know how Panhandle Eastern could make such an offer.

I am talking to you about what was done by Columbia Oil?

A. I should have to refresh my memory, sir.

Q. Don't you remember there was an offer made to the receivers of \$300,000 or thereabouts for the entire interest of the Mo-Kan stockholders?

A. I have stated, sir, that I remember such an offer was made. I remember that there were those proceedings. I remember they were over a rather long period of time.

How they came about or why they came about or the exact details of the offer, I do not recall.

Q. Well, you knew that there were various protective, so-called protective stockholders' committees of Mo-Kan, do you not, which were defending against the proposed plan in the Delaware Court?

[fol. 7377] A. Yes, I remember that rather vividly. It seemed to me they broke out like the measles.

Q. Yes. Then the conflict was on in 1934, you agree to that?

A. The conflict between the stockholders of Panhandle?

Q. The conflict between the stockholding interests and Panhandle Eastern.

A. I should think it might properly be said a conflict of that nature was in existence probably before that, some of the testimony we have read into the record would indicate that.

Q. It was continuous, was it not, up until 1936?

A. I can only speak of that as one who was on the outside looking in and it would seem it was almost continuous. Actually, I cannot tell you.

[fol. 7378] Q. Now, you knew that during the period that [fol. 7379] the trial was going on in the Delaware Chancery Court in 1934, that the protective committees were

attempting to get the Department of Justice to bring an anti-trust action?

A. I suppose they were, sir. Actually, I do not know. I had no contact with those committees and, as I have stated to you, sir, I was present at that hearing for about two or three days.

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Q. You knew that the Delaware Court refused the application of the receivers to compromise their difficulties, that is, the receivers of Mo-Kan to compromise their difficulties with Columbia Oil and transfer to Columbia Oil the last of their holdings in Panhandle Eastern?

A. I do not know that I can identify this thing as an [fol. 7380] application of the receivers. I know that this affair we have been speaking of was never consummated. Let me put it that way, if I may.

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Q. Will you refer to the minutes of the special meeting of the Board of Directors of Panhandle Eastern held at 61 Broadway on Wednesday, November 4, 1931, and state who were present at that meeting?

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A. The Directors present were Messrs. Fred W. Crawford, F. I. Du Pont, Thomas B. Gregory, W. G. Maguire, Charles A. Munroe, Frank P. Parish, Edward Reynolds, Jr., and Stanley A. Russell.

Q. Now, I would like to have you read into the record from the report of the minutes of that meeting beginning with the words, "After said minutes had been read, Mr. [fol. 7381] Parish said", near the top of page 902, and continue to the bottom of the page referring to Volume 82.

A. (Reading)

"After said minutes had been read, Mr. Parish said that he objected to the wording in the letter from Indiana Gas Transmission Corporation referred to therein, which he thought was too broad, and that he wanted it understood and agreed and noted in the minutes that Panhandle Eastern Pipe Line Company was not, by accepting said letter of Indiana Gas Transmission Corporation, waiving its

rights to sell gas elsewhere in Indiana. He stated that the language in the letter as read was so broad that it covered all rights, ideas, and plans that Panhandle Eastern Pipe Line Company might have had or might later have in regard to selling gas elsewhere in Indiana and that he did not propose that it should later be said that the company had forfeited an opportunity which may develop in the future to do business in Indiana by accepting this agreement.

"Mr. Parish specifically asked, in connection with the letter referred to whether it was the opinion of any of the members of this board representing Columbia that if Panhandle Eastern Pipe Line Company should in the future have some opportunity to do business in Indiana it would be claimed then that Panhandle had forfeited such right by accepting this agreement. Mr. Munroe and Mr. Reynolds (fol. 7382) holds answered 'No' to this question.

"The motion having been made and seconded to approve the minutes as read, the chairman put the question to vote, and Messrs. Crawford, Gregory, Munroe, and Reynolds were recorded as voting 'Yes'; and Messrs. Parish, Du Pont, Maguire, and Russell voted 'No.'

"The discussion on the point in question continued, and Mr. Parish made a motion that a court reporter be called into the meeting and instructed to take down the minutes, including all remarks made during the discussion, at this and all subsequent meetings. At Mr. Parish's request Mr. Du Pont, after consideration, seconded the motion.

"Mr. Russell then offered a motion, seconded by Mr. Maguire, that the secretary be instructed to spread the discussion on the minutes. During the discussion of this motion Mr. Munroe said that he felt there could properly be recorded, in connection with the approval of the minutes of the meeting of September 15, the statement that there was no desire to acquire on the part of Indiana Gas Transmission Corporation or to sell on the part of Panhandle Pipe Line Company anything except the property and assets of Panhandle Eastern Pipe Line Company in Indiana as then constituted or later acquired or constructed relating to the pipe line mentioned in the letter.

"After further discussion Mr. Parish withdrew his motion to introduce a court reporter, and Mr. Russell's motion [fol. 7383] that the discussion be spread on the minutes was put to vote and duly adopted, but it was informally agreed that the approval of the minutes of the September 15 meeting would be specifically introduced again at the next meeting of the board.

"The chairman then presented a letter from Mr. George H. Howard, dated October 21, 1931, presenting his resignation as a director of the company. He expressed his regret that Mr. Howard felt it necessary, owing to his other duties, to resign from the board. He suggested that Mr. T. R. Weymouth would make a very valuable addition to the board, to fill the vacancy, on account of his very great knowledge and experience in natural-gas operation in the southwestern fields. Mr. Parish objected to this suggestion and stated that Mr. Weymouth would not be acceptable to him on account of the nature of the questions coming before the board, although he meant this as no reflection on Mr. Weymouth as a gas-operating man; but he suggested that the filling of the vacancy be deferred until after further consideration."

Q. The minutes of that meeting refer to contracts executed under date of October 3, 1931, by Panhandle Illinois Pipe Line Company with Illinois Power Company and Central Illinois Light Company.

Were these the first contracts that were had with the Illinois Power Company and Central Illinois Light Company?

[fol. 7384] A. I do not know.

Q. Will you please read into the record from the minutes of this meeting the concluding portion of the minutes beginning with the words, "After the business on the program had been taken up", which appears near the top of Page 908 of this Volume 82.

A. (Reading)

"After the business on the program had been taken up, Mr. Parish stated that he wished to renew his objections to the previous approval given to the minutes of the meeting of August 13, 1931. He stated that when such minutes

were presented for approval there had never been read in his hearing a certain paragraph which he read to the board for identification and which is noted in the letter from Mr. Ralph M. Shaw, dated October 2, 1931, which letter from Mr. Shaw he demanded be spread in the minutes of this meeting. He said that he had other points of objection to the procedure and conduct of the business of this company which he had set forth in a memorandum which he would not take up time to present at this meeting, but which he would be glad to discuss at anytime with other members of the board; but he did insist that his objection to the approval of the minutes of August 13, 1931, meeting be recorded, made a motion to this effect, instructing the secretary to spread Mr. Shaw's letter of October 2, 1931, to Mr. Parish on the minutes. This motion [fol. 7385] being duly made and seconded and put to a vote, the chairman declared the motion carried. A copy of Mr. Shaw's letter is as follows:"

• Do you wish that letter?

Q. Yes, I would like the minutes read to the conclusion.

A. (Reading)

• Winston Strawn & Shaw,

First National Bank Building, Chicago, October 2, 1931.

• "Dear Mr. Parish: Referring to your letter of September 29 and confirming what I said to you at our conference in Chicago on October 2, touching the minutes of the Panhandle board meeting held on August 13, 1931:

• "Of course I was not present at the meeting and therefore cannot possibly know what in fact took place there, but I direct your particular attention to the third page of the minutes, the third paragraph, reading as follows:

• "Mr. Munroe made it clear that neither he nor any other representative of the Columbia interests had ever said that Panhandle Eastern Pipe Line Company would not sell gas to Missouri-Kansas, but that he did say that representatives of the Columbia interests had expressed grave doubt as to the advisability of the Panhandle management committing the Panhandle Line to deliver firm gas in the quantities and for the periods contemplated in

the proposed contracts with the Columbia and Missouri-
[fol. 7386] Kansas interests.'

"With my knowledge of the past the statement is absurd.

"At the meeting of the board held in New York on May 26, 1931, there is not the slightest possible doubt that the Columbia representatives on the board flatly stated that they would not sell any gas to the Missouri-Kansas Company, irrespective of such excess quantities as they might have at the Indiana State line, and irrespective of price, if the Missouri-Kansas Company proposed to sell it to the city of Indianapolis. They (the Columbia crowd) said they proposed to sell gas in the city of Indianapolis and that the Missouri-Kansas Company shouldn't.

"In my judgment the minutes as drawn were drawn for the purpose of clouding the issue and I do not see how you as a director can acquiesce in the statement in the minutes that Mr. Munroe made it clear, etc. The position taken by representatives of the Columbia Company on the Pan-handle board at the meeting of the latter company above referred to had nothing to do with quantities or prices. It was a plain refusal to furnish gas irrespective of the contract, irrespective of excess volume, and irrespective of price, if you proposed to sell at Indianapolis, and I think you should hammer that in when you are asked to approve the minutes of the board meeting held on August 13 and say that you do not and cannot possibly acquiesce [fol. 7387] in the position that Mr. Munroe made it clear, because it can't be made clear.

"Very truly yours,

"Ralph M. Shaw.

"(Addressed to) Mr. Frank E. Parish,

"President Missouri-Kansas Pipe Line Co., 40 Wall
Street New York."

Mr. Gorman: I wonder if the record heretofore shows who Mr. Shaw was. Was he not attorney for Mr. Parish or do you know, Mr. Watkins?

Q. It was Ralph M. Shaw of Winston Strawn & Shaw of Chicago, was it not?

A. I would assume so, because the letter just read into the minutes of the meeting has that heading. Actually, I do not know who that gentleman was.

Q. Mr. Watkins, refer to Page 916 of Volume '82 of the Federal Trade report and state whether or not Exhibit 6434 which was a letter or report made by Frank P. Parish to Philip G. Gossler, George H. Howard and Frank P. Parish, voting trustees, Panhandle Eastern Pipe Line Company, March 12, 1934, was incorporated or made a part of any of the minutes of the Board of Directors of Panhandle Eastern Pipe Line Company?

[fol. 7388] A. I do not know.

Q. Will you look that up at your convenience, Mr. Watkins, and let us know at a later time? A. I shall.

Q. Mr. Watkins, you were Secretary under the voting trust agreement, were you not?

A. As Secretary of the company, I suppose I was also the Secretary of the voting trustees. Actually, I never acted, as I recall at this moment, in any capacity as Secretary to the voting trustees except perhaps when the voting trust was dissolved and while we are on the subject, I would like to correct the date of dissolution from whatever date the previous record shows, to July 19, 1935.

That was the actual date of dissolution of the voting trust with respect to the common stock of Panhandle Eastern Pipe Line Company and was accomplished by instrumentalities of the voting trustees.

Q. I have a record some place of when you were elected as Secretary of the voting trustees. I thought I could put my hand on it at once.

Mr. Gorman: Yes, I was looking for a similar reference and I find a note on my papers here to the effect, and I merely make this statement to refresh your recollection. Mr. Watkins, so that you do not misspeak yourself, it is to the effect that you were elected and I emphasize the [fol. 7389] word "elected" to Secretary of the voting trustees of the owners of the common stock in Columbia Oil & Gasoline Corporation and—

Mr. Wheat: (Interposing) At what date?

Mr. Gorman: June 7, 1934, which I believe, was about the same date that you assumed the offices of Secretary and Treasurer and became a Director of that corporation and in assuming such position as Secretary of the voting trustees, you succeeded one Edward Reynolds, Jr.

Does that refresh your recollection?

The Witness: I believe you are correct, sir. I know it was about June 7, 1934, that I became Secretary and I recall that I did succeed Mr. E. Reynolds, Jr.

Since there were no activities subsequent to that time involving me as Secretary of the voting trustees and for the further reason I never received any remuneration in that capacity, I was in a complete fog in respect to it.

Mr. Gorman: And that trust was terminated, was it not, on or about May 28, 1936?

The Witness: No, sir, it was terminated on July 19, 1935.

Q. Mr. Watkins, Mr. Bay made weekly reports on his operations back in 1931, did he not, to Mr. Crawford, President of Panhandle Eastern?

[fol. 7399] Q. Mr. Watkins, were gas sales contracts ever executed by Panhandle Eastern with Mo-Kan for the 20 million cubic feet of excess capacity gas at 18 cents per thousand as outlined in the contract of September 17, 1930?

A. They were not but the contract does not stipulate, necessarily, does it, 20 million cubic feet? Doesn't it say up to 20 million?

Q. Up to, I think, yes, but did they execute contracts for any part of it?

A. Panhandle Eastern never executed any contract, so far as I know, with Missouri-Kansas Pipe Line Company for the sale to Missouri-Kansas Pipe Line Company or the purchase by it for any gas whatsoever.

As a matter of fact, as you know, Missouri-Kansas Pipe Line Company had no transmission facilities.

Q. Did it ever execute a contract with Columbia Gas & Electric Corporation providing for the sale of any part of the 20 million cubic feet daily of excess capacity gas at 18 cents as outlined in the contract of September 17, 1930?

A. Not as far as I know except to the extent that it could be said that the sales made to Indiana Gas Transmission Corporation beginning about the latter part of 1931, concerning which the witness was about to refer to a letter yesterday, which letter, I believe, is a part of the minutes of one of the meetings of Panhandle Eastern Pipe Line Company whereby the organization which at that time had an option to acquire a half interest in Panhandle Eastern Pipe Line Company agreed and the Panhandle Corporation concurred in such agreement that, to the extent that Indiana Gas Transmission Corporation purchases its requirements, made up of a part of the quantity of gas that Columbia might purchase pursuant to the September 17, 1930, agreement of which Panhandle Eastern was not a party, that such purchases would be agreeable subject to termination, I believe, on 90 days' notice; and that notice, I believe, could be given by either party.

Those sales, if my memory serves me correctly, commenced, as I have stated, until about the latter part of 1931, which, by the way, was about the earliest date that deliveries could have been made in any quantity and continued on that basis until on or about August 31, 1936, at which time a contract was entered into between Panhandle Eastern Pipe Line Company and Michigan Gas Transmission Corporation.

The contract entered into with Michigan Gas Transmission Corporation at August 31, 1936, I believe you will find carries an effective rate, under certain conditions, at [fol. 7401] about 26½ cents which happens to have been one of the figures referred to in the September 17, 1930, contract, based upon the time when the excess capacity, as you refer to it, and as it may be referred to in the September 17, 1930, contract, became firm deliveries.

Q. Was a written contract ever entered into with Indiana Gas Transmission Corporation by Panhandle Eastern for the sale of gas at 18 cents?

A. No, sir, it was not. It continued, as the witness has stated, under this informal arrangement, which was originated about the time United Light and Power had its options to acquire a certain portion of the ownership of Panhandle Eastern Pipe Line Company and shortly before—

Q. (Interposing) Mr. Watkins, you are usually very accurate, but you do not mean to say "control a portion of Panhandle Eastern", do you?

A. I did not say "control". I said "purchase".

Q. No, but to purchase any portion of Panhandle Eastern, they had no option for that, did they?

A. My understanding is they did ~~because~~ certainly there was some reason Columbia Gas would write to United Light & Power to find out whether or not it was agreeable to them, who had some interest in a purchase—whether or not they had an option, I am not sure—and United Light & Power would certainly not sign an acquiescence [fol. 7402] to such arrangement unless it had some interest.

I can develop that specifically for you, if you do not object. Yesterday you had some objection to my referring to a letter which contained those facts.

Q. Mr. Watkins, the option, as you mentioned, of United Light was never carried out, was it, and they never acquired any interest in Panhandle Eastern property or securities? A. Property or what, sir?

Q. Property or securities?

A. I do not know about securities, sir. They may have owned some of the bonds. The bonds were bearer bonds and I would have no knowledge of that fact.

Q. You never heard of them owning any of the bonds? [fol. 7403]

A. No, and I think they made a rather bad mistake by not owning some of the property, but that is neither here nor there.

A specific answer to your question, as I recall, sir, is, to the best of my knowledge and belief, United Light & Power never owned any of the securities of Panhandle Eastern Pipe Line Company.

[fol. 7404] Q. Now, Indiana Gas Transmission was a subsidiary of Columbia Gas, you say?

A. No, sir; Indiana Gas Transmission at that time, [fol. 7405] I believe, was a subsidiary of Columbia Oil & Gasoline Corporation.

[fol. 7413] Q. Let's complete the record on this contract with Indiana Gas Transmission Corporation by reading into the record a letter of January 19, 1932, which I suggest you will find on Page 1225 of 84-1 of the Federal Trade Commission report:

A. (Reading) "After discussion on motion duly made [fol. 7414] and seconded, it was unanimously

"Resolved, That the arrangements entered into by the officers of this company for the sale of natural gas at the Illinois-Indiana State line to Indiana Gas Transmission Corporation, at the price of .18 cents per thousand cubic feet, and subject to cancellation by either party on ninety-days' notice, be and hereby is in all respects approved, ratified and confirmed."

Q. Will you also include the portion beginning with ~~numb.~~ "93" in which the chairman made his statement about this informal arrangement?

A. That is on Page No. 1225 of the Field Report which has just been identified?

Q. Yes.

A. Following the numeral "93" in brackets, there appears the following:

"The chairman stated that the officers of the company had made an informal arrangement, subject to cancellation by either side on 90 days' notice, for the sale of surplus gas at the Illinois-Indiana State line to Indiana Gas [fol. 7415] Transmission Corporation. He stated that this arrangement had been agreed to by the present and prospective stockholding interests of the company as shown by letters which he submitted to the meeting and copies of which are as follows:"

Q. Now, Mr. Watkins, do you have any data available to you showing the amount of gas which was sold to Indiana Gas Transmission Corporation under this informal arrangement? A. I do.

[fol. 7416] Mr. Wheat: We are able to supply this in exhibit form, Mr. Examiner, if you think it would be well.

May I ask, Mr. Examiner, that the document which the witness has just produced and handed to the reporter be marked for identification with the next exhibit number?

Trial Examiner: This is a statement of gas revenues from Indiana Gas Transmission Corporation and Michigan Gas Transmission Corporation during the period from [fol. 7417] November, 1931, to November, 1941, inclusive, as received or derived by Panhandle Eastern Pipe Line Company and will be marked for identification as Exhibit No. 158.

(Exhibit No. 158 was marked for identification.)

Mr. Chamberlain: Do you offer that, Mr. Wheat?

Mr. Wheat: Yes.

Q. Do you have a statement showing the amount of gas purchased during the same period by Indiana Gas Transmission Corporation from Ohio Fuel Supply Company?

[fol. 7418] The Witness: Well, I do not remember too definitely, Mr. Chamberlain, whether or not Indiana Gas Transmission Corporation purchased much or little gas [fol. 7419] from Ohio Fuel—you said, "Supply Company."

I believe you meant Ohio Fuel Gas Company.

Q. Ohio Fuel Gas Company, yes.

A. They may have purchased some substantial amounts at times. That I do not recall.

My memory at the moment would indicate to me that most of Indiana Gas Transmission's gas was purchased from Panhandle Eastern Pipe Line Company but I have had no contact with that company or any of its records since the date upon which I was last connected with it or an officer of it and my memory is quite hazy as to it.

[fol. 7426], Q. Did Panhandle Eastern have an office in New York at that time?

A. I was located in New York and I was an officer of Panhandle Eastern Pipe Line Company and to the extent that it could be said that the affairs of Panhandle Eastern were being conducted from an office in New York, perhaps [fol. 7427] that would be proper. It paid no office rent. It had no separate space but at the time any of the other officers of Panhandle Eastern from its properties came to New York, they used my space as their headquarters, and so forth.

Q. Well, in your intercompany correspondence in the Panhandle Eastern Corporation, you had correspondence right along in your New York office in 1934.

Q. (Interposing) Pardon me, I mean '34, '35, '36.

A. There were letters written between Kansas City and any of the officers or Directors of Panhandle Eastern Pipe Line Company all through the period of its organization, as far as I know, wherever those people might have been at any particular time and some of the officers of Panhandle Eastern Pipe Line Company, and there is no secret about it, were likewise officers of some of the Columbia Gas companies and they had mailing addresses at New York and it was at 61 Broadway and I believe their offices may have been on the 29th floor of that building or some of them may have been on the 30th floor of that building and when it became necessary for any correspondence to be had between those officers, it was had to the same extent that any correspondence might be had with anyone.

[fol. 7428] connected with Missouri-Kansas Pipe Line Company or anyone else.

[fol. 7451] Trial Examiner: The original studies of Mr. Coffman, which were marked for identification as Exhibit 63, covering risks of capital, No. 64, the supporting data related to Exhibit 63, and No. 65, rate of return, will be received in evidence without objection by corresponding numbers.

Likewise, Exhibit 150, relating to common-stock issues, No. 151, covering earnings-price ratios, No. 152, being a study of the effect of recent income and excess profits tax provisions, will be received without objection by corresponding numbers.

[fol. 7452] PAUL B. COFFMAN, a witness, having been previously duly sworn, resumed the stand and testified further as follows:

Cross-Examination (Resumed).

By Mr. Littman:

Q. Mr. Coffman, when you were last on the stand, I asked you to check certain weighted average earnings-price ratios of natural-gas pipe-line common stocks for companies which are shown in your Chart No. 19.

Have you made a check of the weighted average earnings-price ratios which I read into the record at the last session?

A. Yes, sir, I have. I checked the arithmetic, in other words, the figures are properly calculated on the basis that you used.

Q. It is clear, is it not, from Chart No. 19 of Exhibit No. 65, that your average earnings-price ratios for each of the years 1937 to 1940, inclusive, include certain earnings-price ratios of Interstate Natural Gas Company?

A. Yes, sir.

Q. And the same is true, is it not, of your "Average of pipe-line companies" of 12.99 percent shown in Chart No. 22 based on the 1941 market prices?

A. Yes, sir, that is correct.

Q. What was the market value as of December 31, 1940, of the common stock of Interstate Natural Gas Company? In that connection I refer you to Exhibit No. 64, Appendix [fol. 7453] C. A. What was the date?

Q. December 31, 1940. That is at Page 107.

A. Now, the average of the high and low price on the capital stock of Interstate Natural Gas Company, Inc., for the year 1940 was \$23.88.

Q. What was the total market value for all of the outstanding common stock of that company?

A. Using the average price just mentioned and multiplying it by the number of shares outstanding as of December 31, 1940, which were 952,953 shares, you have got a total market appraisal as of that date of \$22,756,518.

Q. Now, what was the book value of the common stock of Interstate Natural Gas Company for the corresponding period? I refer you to Exhibit 64, Appendix B, Page 3.

A. Is that reference correct?

Q. Appendix B, Page 3, I believe it is, you will find it near the bottom of the page.

A. Are you talking about just the total securities outstanding?

Q. Yes, because I understand Interstate Natural Gas Company has no securities outstanding other than common stock.

[Q.] No, I just wanted to be sure. What you mean at the moment is the total dollars, not a per-share figure. That is what I want to get straight.

The total securities outstanding as shown in Appendix [fol. 7454] B, Page 3, for the Interstate Natural Gas Company as of December 31, 1940, was \$6,529,530.

Q. Now, in order to get the book value of that common stock, including the surplus, you would have to add thereto the surplus, would you not? A. Yes.

Q. Now, the surplus figure is not shown in your exhibits, is it? A. No, sir.

Q. I hand you a copy of Moody's Public Utilities for the year 1941 and ask you to refer to that volume and

state the amount of surplus for Interstate Natural Gas Company for the year 1940.

A. The surplus of the Interstate Natural Gas Company, as of December 31, 1940, as shown in Moody's Public Utilities Manual for 1941, Page 1122 is \$5,873,982.

Q. Now, adding the surplus figure to the book value of the common stock, produces a total of \$12,403,000 odd, which represents the book value of the common stock and surplus as of December 31, 1940, for Interstate Natural Gas Company. Is that correct?

A. Yes, sir, that is correct.

Q. Now, it is obvious, is it not, that the market value of the common stock of Interstate Natural Gas Company, which you stated to be \$22,756,518, is almost double the [fol. 7455] book value of that stock as of December 31, 1940. Is that right?

A. Well, the market value as stated is \$10,353,000 in excess of the book value as stated.

Q. Now, the El Paso Natural Gas Company is another natural-gas pipe-line company which is included in your 12.99 percent, "Average of pipe line companies," based on 1941 market prices shown in your Chart No. 22. Is that correct? A. That is correct, yes, sir.

Q. Now, will you state the market value of the common stock of El Paso Natural Gas Company for the year 1940?

A. The total indicated market value of the El Paso Natural Gas Company, as shown in my Exhibit 64, Appendix C, Page 101, is \$33,000,000—

Q. (Interposing) Pardon me, Mr. Coffman. I would like to have the year 1940 and I believe that is shown in your Appendix C at Page 104, is it not?

I am sorry, I have the wrong number.

A. It is 101, I believe.

Q. I beg your pardon. It is shown on Page 101.

A. All right. That total is \$33,411,781, which is for the year 1941 and is based on the average of the high and low prices for the securities and for the full-year period.

Q. You mean for the year 1940?

[fol. 7456] A. 1940; yes, sir.

Q. I would like to have the market value of the common stock only of the El Paso Natural Gas Company for the year 1940.

A. As shown in my Exhibit 64, Appendix C, Page 101, the indicated market value of the common stock of the El Paso Natural Gas Company, based upon the average of the high and low price for the year 1940 was \$20,418,100.

That is, of course, merely the market quotation, including the market appraisal of surplus, and so forth. I merely want to be clear about it; the market quotation, so far as the investor is concerned, pays the full worth of the common stock.

Q. Including the surplus?

A. That is right.

Q. I so understood.

Now, will you please state the book value of the common stock of El Paso Natural Gas Company as of December 31, 1940, exclusive of surplus? I believe that figure is shown on Page 3 of Appendix B of Exhibit 64.

[fol. 7457] A. That, Mr. Littman, is not quite correct because of Knapp's figures, which are contained in my Appendix B, Page 3. Those figures there refer to June 30, 1941, so that I will have to refer, if you want the December 31, 1940, figures, to Moody's Manual.

Q. Perhaps we had better do that in order to have the figures on a comparable basis.

A. The book value of the common stock of the El Paso Natural Gas Company as of December 31, 1940, is shown in Moody's Public Utilities Manual, Page 30, as \$5,301,994, not including surplus.

Q. That figure is the same as the figure which you show in Appendix B of Exhibit 64, Page 3 as of June 30, 1941, is it not?

A. Yes, sir, the figures coincide.

Q. Now, will you please add the surplus and give me the total book value of common stock of El Paso Natural Gas Company including surplus as of December 31, 1940?

A. The surplus of El Paso Natural Gas Company as of December 31, 1940, as shown in Moody's Public Utilities Manual for 1941 at Page 30, amounts to \$4,194,039 and that figure, added to the \$5,301,994, gives a total book figure for common stock and surplus of \$9,496,033.

Q. Which is the book value of the common stock of El Paso Natural Gas Company, including surplus, as of December 31, 1940?

A. Yes.

Q. Now, it is evident, is it not, that the market value of that stock for the year 1940 of \$20,418,100 is more than twice the book value? Is that correct?

A. Yes, the excess of the market value over book value is \$10,922,076.

Q. Now, I would like to have you turn to your Chart No. 18 of Exhibit 65 entitled, "Historical costs of Preferred Stock, Capital, of Panhandle Eastern Pipe Line Company as of 1937-1941."

I would like to discuss with you the preferred stock of Panhandle Eastern Pipe Line Company. Now, on this chart you show the actual historical costs of the preferred stock for the years 1937 to 1940, inclusive, and you have estimated the cost for the year 1941. Is that correct?

A. That is correct.

Q. Now, will you please turn to the table for Chart No. 18? You show on this chart that Panhandle Eastern Pipe Line Company presently has outstanding \$6 Class A preferred stock, participating and redeemable, having a par value of \$100 per share in the total amount reflecting par value of \$10,000,000 for each of the years 1937 through 1941.

A. Yes, sir.

Q. And in addition, Panhandle Eastern has \$6 Class B [fol. 7459] preferred stock, non-participating and non-redeemable having \$100 par value per share, a total outstanding par value of \$1,000,000 for each of the years 1937 through 1941. Is that right?

A. Yes, sir.

Q. Now, that makes the total outstanding preferred stock \$11,000,000. Is that right?

A. Yes, sir, according to the books.

Q. Now, the Class B preferred stock, of which there is \$1,000,000 outstanding, receives a straight 6 percent dividend per year and is not entitled to any participation in further dividends, isn't that correct?

A. That is correct.

Q. However, the Class A preferred stock, of which there is \$10,000,000, is entitled not only to the \$6 regular

dividend per year but, also, is entitled to participate to the extent of 25 percent of additional dividends on common stock after \$1.50 per share has been declared or paid in any one year. Is that your understanding?

A. That is my understanding.

Q. And as your Chart No. 18 shows, there have been participating dividends paid in 1940 and in 1938. I believe that is more clearly shown in the table for Chart No. 18, is it not?

A. Yes, that is correct.

[fol. 7460] Q. In other words, in the year 1938 the holders of the Class A preferred stock received not only \$600,000 by way of regular 6 percent dividend on the \$10,000,000, but, in addition, received \$182,163 as a participating dividend. Is that right?

A. That is correct.

Q. And you show that in the year 1940 those preferred stock holders received \$403,684 by way of participating dividends?

A. That is correct.

Q. Now, the regular 6 percent dividend has been paid on both classes of preferred stock through the years, isn't that right?

A. Yes, sir, that is through the years 1937 to 1940, as shown in the table, I mean without going back beyond that.

Q. Yes. Now, you show an estimated participating dividend for the year 1941 in the sum of \$269,122. Is that correct?

A. That is correct.

Q. And you have used this figure of \$269,122 as the estimated participating dividend for the year 1941 in calculating the 8.45 percent shown for the year 1941 in your Chart No. 18, is that right?

A. Yes, sir, I have.

[fol. 7461] Q. Now, you estimated this amount of \$269,122 upon the assumption that in the year 1941 Panhandle Eastern would pay a common-stock dividend of \$2.50. Is that right?

A. Yes, sir, that is correct.

Q. In other words, the common-stockholders would receive, first, \$1.50 and out of the remaining dollar the preferred stockholders would [received] 25 cents and the com-

mon stockholders would receive 75 cents. Is that right, is that the way you computed it?

A. That is right. For each dollar of dividend over and above the \$1.50 of common, it was shared 75-25 percent.

Q. Now, will you please check your \$269,122 and tell me whether that is a correct figure? I believe you will find it to be in error.

A. I think the figure is correct.

Q. Will you tell me how you compute the figure?

A. Well, the first calculation is based upon the \$807,367 per share of common stock and the \$1.50 shares total \$1,211,051, that is the first payment prior to participation.

An additional dollar available makes \$807,367. That is the equivalent of one additional dollar per common share which has to then be divided on a basis of 25-75 percent, the preferred participating 25 percent, and the common participating, 75 percent.

[fol. 7462] Q. Well, if what you have just said is the fact, and I so understand it to be the fact, you would take the \$807,367, which represents \$1 over the dollar and one-half for each of the 807,367 shares of common stock, and divide that amount by 4 in order to determine the 25 percent, which is the extent to which the preferred stockholders of the Class A preferred have a right to participate, and that would give you \$201,842 instead of the \$269,122, which you show in your table for Chart No. 18.

Now, I believe that you divided the \$807,367 by 3 instead of by 4.

A. That is correct, that is how the \$269,122 was calculated.

Q. Well, now, the \$269,122, which you show in your table for Chart No. 18 is certainly in error, is it not? The figure should be \$201,842, according to my arithmetic.

A. Well, except that I think you are neglecting to take into consideration that the dividend calculated upon the common stock, the total dividend calculated upon the common stock is \$2.50.

You have taken out the 25 percent from the common stock. The common stock did not receive an additional 75 cents, the common stock received an additional dollar and

the 25 percent that the preferred received was excluding the dollar, because the common-stockholders received a net dividend of \$2.50, not a net of \$2.50 minus the [fol. 7463] participation to the preferred, so that on that basis you would have to calculate that once you had arrived at a figure of \$807,367, then you would figure that that amount was three times as great as the preferred participation.

What you are doing is saying that the total amount of dividend paid was an even dollar which had to be split 75:25. I am saying that the dividend directly to the common-stockholders is \$1, so there has to be a dividend greater than that amount in order that the preferred holder will get his 25 percent participation.

That is absolutely mathematically correct.

I do not know whether I make my point to you clear, but if I can, I think you will agree with me, Mr. Littman. I think what you are saying is that the total amount of earnings available for distribution over and above the \$1.50 was \$1.

I am not saying that, I am saying that the common-stockholder received \$1.50 plus one full dollar, making a total dividend of \$2.50. He did not share any part of that additional dollar with the preferred.

The earnings that were shared were in excess of \$1 from which the preferred received his participation, therefore, what I did was to calculate it on this basis. The additional dollar, the additional \$1 to the 807,367 shares is \$807,367 and the participation of the preferred, then, this [fol. 7464] would be in the ratio of one third that amount.

Q. Now, Mr. Coffman, that isn't the way the company figures it at all, is it? Look at the year 1940, in which year the company paid \$403,684, which covered the years 1939 to 1940 and included two such participating dividends and divide that by two and see what you get.

Then, you will have the method that the company, itself, uses.

The Witness: Will you please read that back?

(Whereupon, the pending question was read by the reporter.)

The Witness: What table are you looking at, Mr. Littman?

By Mr. Littman:

Q. I am looking at your table for Chart No. 18.

A. Yes. Well, the total of \$600,000 plus the \$403,684, if I understand you correctly, is \$1,003,684. Then you say, divide that by two?

Q. No. I am confining my present line of inquiry to the \$403,684 participating dividend paid in the year 1940.

Now, divide that by two, because that amount includes two years of participating dividends, and you will get a figure of \$201,842.

A. By dividing by two, that is the figure.

Q. Now, if you will take 25 percent of the \$807,367 you will get the same amount, namely, \$201,842. Is that correct?

[fol. 7465] A. By dividing the \$807,367 by 4 you get \$201,842, that is correct.

Q. Doesn't that indicate to you that that is what the company does when it computes the participating dividend, namely, it takes 25 percent of the dollar available for dividends over the \$1.50, namely, the latter dollar of the \$2.50 dividend on the common and takes 25 percent of that and distributes it to the preferred stockholders, which is the very method that you described before I called attention to your total figure?

A. Well, so far as the arithmetic is concerned, Mr. Littman, that may very well be the case, but so far as the calculation which I estimated for 1941 is concerned, I have described exactly how it has been arrived at and I believe that is very definitely in line with the provisions of the preferred stock.

[fol. 7466] In other words, in this case I did not have actual earnings to go on, so before I could make any division I first had to decide what would be a reasonable estimate over-all for the common stock, and that total was \$2.50. Then I merely assumed that the additional participation would have to be over and above that amount. I believe

that follows the provisions of the preferred stock. The mere fact that you can go back and divide the company's figures in the past year by something else, it seems to me, is a different calculation. There you have actual figures to work on and it can be worked out and divided any way you please.

Q. Are you stating, Mr. Coffman, that the Class A preferred stockholder is entitled to something more than 25 percent of the \$1.50 dividend paid to the common stockholder?

A. No, that is not my intention. All I am saying is that the total amount paid to the common is net. In other words, it is \$2.50 to the common holder, and in order, therefore, to have a 25 percent participation, if common is going to result with a \$2.50 payment, that 25 percent will have to be calculated out of earnings over and above.

Q. Let me read from the Securities and Exchange Commission Release No. 3299, dated January 29, 1942, in the matter of Panhandle Eastern Pipe Line Company, File No. 70-447, Findings and Opinion, where it states at page 2, "The Class A Preferred Stock, in addition to a preferred [fol. 7467]ential cumulative dividend of \$6 per share, is entitled to receive as a class one-fourth of all dividend distributions in excess of \$1.50 per share on the common stock declared or paid in any one calendar year."

Now, is that your understanding of the preferential dividend to which the Class A preferred stockholders are entitled?

A. That is correct, but in this dollar that you get for common stock, you are not taking a part of that to give to preferred under the very stipulation that you read. If you did, you would not have \$2.50 common dividend; you would have \$2.50 minus the difference. How can you get around it?

Q. Now, how much did the company pay by way of a dividend on the common stock in 1940?

A. \$1,200,684 were paid in dividends on the common stock for the year ended December 31, 1940.

Q. Well, how much was that per share?

A. Pardon me, I am giving you the figure for El Paso. I am sorry. The total dividends paid on common stock for

the Panhandle Eastern Pipe Line Company for the year ended December 31, 1940, was \$2,422,101.

Q. How much was that per share of common stock?

A. That was equivalent to \$3 per share on 807,367 shares.

Q. Now, what was the common stock dividend that was paid in the year 1939?

Mr. Sutton: You are satisfied with that calculation, are [fol. 7468] you not? It is the same thing he has been saying, it works out on the same principle.

Mr. Littman: Not at all, not at all. It simply cannot be.

The Witness: The total dividends paid on common stock by the Panhandle Eastern Pipe Line Company for the year ended December 31, 1939, was \$1,132,336.

By Mr. Littman:

Q. Now, what does that amount to per share?

A. It is equivalent to about \$1.04 per share. The same number of shares in 1939.

Q. Will you please recalculate that \$1.04-per-share figure? That does not look right to me.

A. The amount of common dividends was \$1,132,336, and the number of shares is 807,367. I think the machine is as bad as I am on the figures, this is \$1.40. Wait until I check my figures. That is correct. I misplaced one digit. \$1.40 is correct. I will go by the machine even though I think it is wrong.

Q. Well, we will check your calculations and come back to this subject after so doing.

At any rate, it is your testimony that the proper way of calculating the dividend to which the Class A preferred stockholders are entitled for participation purposes is as follows:

[fol. 7469] Assuming that the dividend paid to the common stockholders is \$2.50 in a given year, you first deduct the \$1.50, leaving \$1 in which the Class A preferred stockholder is entitled to participate, and then divide that dollar by three? Is that your testimony?

A. What I say is, where you have to make an estimate as I did, as to a common dividend, the amount of money, which is here \$2.50, all went as a dividend to the common stockholder. Now, obviously, following the provisions of the preferred stock certificate, the preferred are entitled to participate in such distribution over and above the \$1.50. The common stockholder actually received \$1; then the preferred participation must have been out of earnings over and above the \$1. It did not come out of the dollar, because the common stockholder got it, so it could not have come out of the dollar.

Q. Mr. Coffman, I understand your position with respect to all that. But can't you tell me how you get at the figure, what calculation do you use? Do you divide the dollar by three or four?

A. I say, for the extra dollar that is available and above the \$1.50, you figure that out on the basis of three, because for the amount over and above a dollar the common stockholder gets three times what the preferred holder gets, so it is three, not four, that we are talking about.

[fol. 7470] Q. In other words, you divide the dollar by three to get 33 $\frac{1}{3}$ cents for each dollar by way of participation for the Class A preferred stockholder?

A. Or divide the \$807,367, which is \$1 per share, by three.

Q. By three?

A. That is correct.

Q. And that is your interpretation of the statement which I just read to you from the Securities and Exchange Commission, namely, that "The Class A preferred stock in addition to a preferential cumulative dividend of \$6 per share is entitled to receive as a class one-fourth of all dividend distributions in excess of \$1.50 per share on the common stock, declared or paid in any one calendar year"?

A. That is correct.

Q. Now, will you state whether or not that is the method used by the company, namely, the method of dividing the amount over and above the \$1.50 by one-third instead of one-fourth? Now, you have told us that is your method. I want to know whether that is the company's method.

A. I have not investigated the company's method as such, as I have stated throughout my testimony, but I

believe that is the method as recorded and shown in the annual reports.

Q. Well, you are not prepared at this time to say that the company calculates the participating dividend in the [fol. 7471] way that you have calculated?

A. As such, I have never prepared it nor have I ever asked them for any calculations nor have I asked to see their books prior to determination of the dividend to see how they ascertain it, so I could not say, specifically, but I think they do follow that method.

Q. Well, why do you think that without having first made an investigation of whether they do actually calculate it in that way? What is the basis for your thinking?

A. Because I think it can be shown from the 1940 figures that that is what it amounts to, as shown by the figures given for dividends and participation.

Q. Well, suppose you make the calculation, let us say, during the noon recess, and satisfy yourself that that is the way they do it.

A. On the 1940 figure?

Q. Yes.

Mr. Wheat: I suggest we do it now. It is not a long job, is it?

The Witness: My associate already made the calculation, so I can explain what we did on the 1940 figures right now.

By Mr. Littman:

Q. All right.

A. The dollar and a half per share on 807,367 shares gives you \$1,211,051.

[fol. 7472] Q. Will you read that back?

(The last answer of the witness, as above recorded, was read by the reporter.)

The Witness: Now, as I have already stated, the total dividends on common amounted to \$2,422,101, which I calculated for you to be at the rate of \$3 per share, so that means that there must have been \$1.50 participation over and above the \$1.50 as the starting base, so that would mean \$1,211,051 for participation.

Mr. Culton: To the common stock?

The Witness: Yes, to the common stock.

By Mr. Littman:

Q. And that is for what year?

A. I am talking about 1940 altogether, so we can check this figure.

Now, the only way that you can get \$403,684, as shown in my table for Chart No. 18, as reported, is to divide the \$1,211,051 by three, and that is the way the company is doing it. Therefore, I say I think that must be the practice followed by the company, although I was not at the company's offices to check it and I have not asked them to give me any statement about it, but I do not know any other way to get that figure that they report.

Mr. Culton: And that would be a fourth of what aggregate dividend paid?

[fol. 7473] The Witness: Of the total participation to the preferred plus the total over to the common, that is the total common dividend.

By Mr. Littman:

Q. But if you will turn to your Chart No. 18 you will observe that the dividend paid in 1940 was paid out of 1939 earnings. Now, have you taken that into account?

A. Well, insofar as the indenture is concerned, it would not make any difference, Mr. Littman.

Q. Yes, but the earnings which you read on the common stock were for the year 1940.

A. Well, the total dividend paid in 1940 was such and such amount, so what difference does it make? The matter of when the dividend was paid has no bearing on this problem, so far as the calculation is concerned.

Q. Now, will you please—

Mr. Wheat: (Interposing) Pardon me, does this calculation now satisfy you?

Mr. Littman: I will have to check it a little further.

Mr. Wheat: Surely.

By Mr. Littman:

Q. I can see that the witness is convinced that he is right about it and apparently has a basis for it. I would

like to check the matter a little further, because it so happens that the \$403,684 figure shown as the participating [fol. 7474] dividend for the year 1940, when divided by two, comes out to precisely the amount of \$201,842, which is one-fourth of the \$1 amount. In other words, it checks my figures on the subject, so I want to examine it further.

Mr. Wheat: It checks both ways.

Mr. Culton: A suggestion for you to consider is that it shows the relation of \$1.50 extra dividend to a dollar extra dividend. That is the reason why the peculiar relationship exists.

Mr. Wheat: May I suggest, Mr. Littman, that possibly Mr. Dunn might check this for you and possibly, if there is still any question, they might discuss the matter with the witness so we will come to a conclusion. I think it is a simple matter eventually.

Mr. Littman: I think so. My only purpose, of course, is to make certain that the method used is correct.

Mr. Wheat: Oh, sure.

Mr. Littman: And once we are satisfied as to that, why, we will proceed with the matter no further. I am certain if there is an error in these figures, you will want them corrected too.

Mr. Wheat: Surely.

Mr. Littman: Very well, we will check the matter and report back on it.

By Mr. Littman:

[fol. 7475] Q. Now, will you please turn to your Chart No. 37? This chart reflects and shows the amount of dollars needed by Panhandle Eastern under the assumption that the company will continue to have outstanding its present Class A preferred stock?

A. Yes, that is the assumption on Chart No. 37.

Q. And the preferred stock requirement of \$929,122, shown in your Chart No. 37, is based upon your estimated amount for the year 1941, or estimated cost of that preferred stock of 8.45 percent?

A. Well, and plus the consideration of a \$2.50 annual dividend on the 807,367 shares of common stock. I mean,

if you refer in connection with that, Mr. Littman, to the table for that chart, you will see the point that I am making, about two-thirds of the way down in the right-hand column there is an item "Preferred Dividend Requirement Based on Maximum Participation of Class A Preferred Stock, \$929,122." The explanation, therefore, is participation of the Class A preferred computed on the basis of a \$2.50 annual dividend on 807,367 shares.

[fol. 7476] Q. Where do you find the word "maximum" in your table for Chart No. 37?

A. That is parenthetical in the explanation at the left-hand side where you see the item mentioned, "Preferred dividend requirement (based on maximum participation of Class A stock").

In other words, I had to make some allowance, not only as to the actual dividend but as to a participation.

Q. Now, Mr. Coffman, this "based on maximum participation of Class A preferred stock" which is stated in your table for Chart No. 37 refers to \$1,388,480, does it not, and does not refer to \$929,000-odd?

A. Yes, I stand corrected on that. The \$929,000 is based upon the \$2.50 distribution of common which may or may not be maximum. I mean it could be more or it could be less.

Q. At any rate, the \$929,122 of dividends paid to the preferred stockholders reflects the regular 6-percent dividend and, in addition thereto, the Class A preferred stockholders participation in a \$2.50 annual dividend on the common stock, isn't that right?

A. No, we are getting back on the same confusion again. It represents the preferred stockholders' participation in the amount properly calculated wherein common actually receives \$1 over the \$1.50, so we would not get the [fol. 7477] confusion of whether they are sharing in the dollar or sharing in something more than a dollar.

Q. This \$929,122 amount to be distributed to the preferred stockholders which is reflected in your Chart 37 is also shown in your table for Chart No. 18 for the year 1941, is it not?

A. That is the total, that is, \$600,000 regular dividend and \$269,122 participation.

Q. For the Class A preferred?

A. For the Class A.

Q. Plus \$60,000 to service the Class B preferred stock?

A. Correct.

Q. Now, isn't that a rate of 8.45 percent which is the rate which appears in Chart No. 18 for the year 1941, estimated?

A. That is the percentage cost made upon the basis of that figure to the total amount of shares.

Q. And I believe that same 8.45 figure appears in some other charts?

A. That is correct.

Q. For instance in Chart No. 26?

A. That is correct.

Q. Is there any doubt in your mind, Mr. Coffman, that the \$10,000,000 of outstanding Class A preferred stock can be refinanced today at more favorable rates than 8.45 [fol. 7478] percent which you have assumed for the purposes of your Chart No. 37?

A. Well, taking the cost to the company, I am not sure that that can be done.

Q. There is some doubt in your mind?

A. Yes.

Q. Is there some doubt in your mind?

A. Yes, there very definitely is.

Q. Is it your testimony that 8.45 percent is a reasonable cost of preferred-stock money to Panhandle Eastern as of today?

A. Talking in terms of the cost, I am saying that that portion of the investing public who would have to be approached to supply this money would say that they would require approximately that percentage in order to be encouraged to supply money to this company on a preferred-stock basis.

Q. That is your testimony?

A. That is my testimony, yes.

Q. Now, according to your Chart No. 18, the preferred stockholders received in 1940, 9.67 percent, did they not?

A. That is correct.

Q. And, in 1939, they received 6 percent and over the period 1937—withdraw—what does this weighted average of 8.02 on Chart No. 18 reflect? Does it include the year 1941?

A. Yes, it does, and that reflects each individual year [fol. 7479] shown in Chart No. 18 of Exhibit 65 but on a weighted-average basis wherein we give the greatest weight to the most recent trend so that the estimated 1941 figure would carry a weight of 5; the 1940 figure a weight of 4; the 1939 figure a weight of 3; 1938 figure a weight of 2; and the 1937 figure a weight of 1.

In other words, we give the greatest weight to the most recent trend.

Q. Now, what company has held all of the outstanding preferred stock of Panhandle Eastern through the years 1937 down to date?

A. The Columbia Oil & Gasoline Corporation, a subsidiary of Columbia Gas & Electric Corporation.

Q. Now, Columbia Oil & Gasoline Corporation also holds slightly in excess of 51 percent of the common stock of Panhandle Eastern, does it not?

A. Yes, that is correct.

Q. And inasmuch as this preferred stock is not in the hands of the public, you have no market quotations on it, do you?

A. That is right.

[fol. 7480] Q. Mr. Coffman, I believe that you testified just before the recess that all of the outstanding preferred stock of Panhandle Eastern is now owned by Columbia Oil & Gasoline Corporation and that that situation has obtained for the past few years, back as far as 1937, is that correct?

A. Yes, that is correct.

Q. And Columbia Oil & Gasoline Corporation is the holder of slightly in excess of 50 percent of the common stock of Panhandle Eastern?

A. That is correct.

Q. Have you made any study of the history and background of this preferred stock, particularly the \$10,000,000 of Class A preferred?

A. Well, only to the extent of knowing, generally, what type of preferred stock it is and the fact that Columbia Oil & Gasoline Corporation held it and the fact that there is at the moment and was a callable feature in there which

I believe was to become effective in June of 1941 which was recently waived.

As I recall it, it was a stock which could have been called at \$10 up to that date and that provision has been temporarily waived in view of some present financing plans which are contemplated.

Q. You know, do you not, that this Class A preferred [fol. 7481] stock can be redeemed today at \$100 par?

A. Since they waived the callable \$110 price at or around June, 1941, that is correct.

Q. Now, do you know that in July of 1939 offers were made by banking groups to market a cumulative non-participating preferred stock for Panhandle Eastern bearing dividends of $4\frac{1}{2}$ to 5 percent, the proceeds of which could be used to retire the Class A stock of Panhandle Eastern?

A. I remember something about those offers and, in connection therewith, I believe I also remember correctly that there were numerous qualifications and restrictions placed upon those offers so that one could not generalize about the situation unless you went into considerable detail in regard to those offers.

I have here, as you know, been talking about the present capital structure which means the present type of preferred stock outstanding and no others and any new offer would have to be considered in view of what ever restrictions were made.

In other words, I think I remember some offer that was made by Gloré-Forgé as one banking group but, as I recall, the offer was couched in very careful language in regard to certain provisions which would have very definitely had a bearing upon an issue and would have to be considered in any analysis.

[fol. 7482] Q. Have you examined the offer?

A. I remember seeing some of the stipulations. I do not recall what they were but I do recall that I formed the opinion at the time that such stipulations were considerably restrictive and would change the nature of the new preferred and would have a very pertinent bearing upon any considerations.

Q. Are you saying that in 1939 it was impossible to refinance this \$10,000,000 of Class A preferred stock at a cost slightly in excess of 4½ percent?

A. I say that to finance this preferred stock by an identical preferred stock at such rates as you mentioned would very likely have been impossible.

If you want to put out a different kind of preferred stock with various provisions for sinking fund and a number of other things whereby the new preferred would be more akin to bonds than the present preferred, that is an entirely new study.

It has no bearing directly upon the present preferred which we have been talking about, at least for all of this morning.

Q. Does it have no bearing upon the return to which this company is entitled?

A. Well, it has very definitely a bearing, the same as I have shown in Chart 36 of Exhibit 65 wherein I say that [fol. 7483] if you assume a refinancing of the preferred stock, the present preferred stock, partly with bonds and partly with common stock, the required amount for return of capital is less on my present approach as shown in Chart No. 36 than is the case for the requirement on the basis of the present capital structure as shown in Chart No. 37.

Q. Well, is it your testimony that your suggestion is the best that the company could do by way of refinancing this \$10,000,000 of Class A preferred stock, your suggestion which is shown in Chart No. 27?

A. I say that my suggestion is one very definite reasonable proposal but, as I think I have already testified, after analyzing information shown in Chart No. 25 of Exhibit 65, I concluded if there was to be a change made for a company in an industry such as we are talking about, it might be preferable to perhaps eliminate a preferred stock altogether so that, on that basis, I had concluded if some arrangement could be made for refinancing the present capital structure perhaps some way could be worked out to have merely bonds and common stock as one method and I tried to apply that.

Now, there may be others. I really did not go through an entire explanation of them but in my approach here, I

think I have shown fairly clearly that if the suggestion of bonds and common stock is used as a new setup in comparison to the present, the requirement would then be as shown on Chart 36, namely, \$4,993,511 required for what I call current capital requirements as against \$5,064,821 for a similar requirement but based upon the present capital structure as shown in Chart No. 37 of Exhibit 65.

Q. There is not much of a saving there after your method is applied, is there?

A. Not so much saving on this basis, no.

Q. How much is it in dollars if your proposed plan of refinancing the present preferred stock by means of 50 percent bonds sold at 3.25 and 50 percent common stock sold at 12 percent?

Mr. Wheat: Fifty percent of the total amount of present outstanding preferred?

Mr. Littman: That is right.

Mr. Wheat: Not 50 percent over-all.

Mr. Littman: That is right. I am reading from the witness' Chart No. 27.

Mr. Wheat: Yes. Thank you.

By Mr. Littman:

Q. Now, what I want to know is, Mr. Coffman, what savings in dollars will result by the application of this proposed refinancing which you have suggested in your Chart No. 27?

A. \$71,310.

[fol. 7485] Q. And the rate of cost of money would be 7.63 percent for the \$11,000,000 of refinancing, would it not?

A. Where do you find the 7.63 percent?

Q. I obtained that figure in this way:

Refer, please, to your Chart No. 27. I take 3.25 percent which is the rate on the bonds and 12 percent which is your rate on the common stock, add the two, giving 15.25, and dividing by 2.

Do you follow me?

A. Yes, I see what your calculation is but I want to check a figure.

Q. What I am seeking is to have you express the cost of money in terms of percent so that it may be compared with the present assumed cost of preferred stock money of 8.45 to which we have heretofore referred.

A. Well, I think that in answer to your question you would refer to Chart No. 28 because, if you finance on a 50 percent—that is, if you refinance the present preferred outstanding so that when you get through you had approximately a 60 percent common-stock figure and a 40 percent bond figure, the percent would be 8.40 percent.

Q. I do not want an over-all cost including common stock and bonds and everything else. I merely want you to state the cost of money for the refinancing of the outstanding \$11,000,000 of preferred stock under your assumption, which assumption is set forth in Chart No. 27.

A. I do not recall your figure. It would be about 7.86 even. I thought you said 56, did you?

Q. The figure I gave you was 7.63.

A. Well, I figure 7.86.

Mr. Wheat: Just what is that figure, Mr. Coffman?

Mr. Littman: Yes, state how you computed it.

Mr. Wheat: And what it represents.

The Witness: The figure I have given you is the total of the present capital structure which is \$63,525,839 and applied against that the requirement of refinancing the preferred stock of \$4,993,000.

By Mr. Littman:

Q. Well, isn't that the same figure which is shown in your table for Chart No. 27 at the bottom of the chart under the heading, "Yield rate" of 7.85?

A. Well, it so happens that the figures are the same.

Mr. Wheat: I thought you said one was 7.86?

The Witness: This is 7.85. I happened to carry it out one additional decimal point—it comes out 7.859 so I said, 7.86.

By Mr. Littman:

Q. The two figures are identical?

A. The two figures are identical but I did not arrive at this figure in the way shown here.

[fol. 7487] Q. At any rate, it is your testimony, Mr. Goffman, that if your assumed refinancing of the outstanding preferred stock were adopted and were to take place today, the cost of refinancing the \$11,000,000 of outstanding preferred stock would be 7.86 percent, is that right?

A. Yes, based upon the calculation I have just given you.

Q. Whereas the present cost which you have estimated and included for purposes of your Chart No. 37 is 8.45 percent?

A. As against the preferred stock requiring 8.45 percent, that is correct, but one, however, is an over-all capital calculation and the other is a calculation directed to preferred stock only.

Mr. Culton: I think there is an unintentional misuse of the word "today". You do not mean on the market as of February 2, do you?

The Witness: No, I mean as of the date of this study, obviously, I have not made any study as of today.

By Mr. Littman:

Q. Now, what, in your opinion, would be the best terms under which Panhandle Eastern could refinance this \$11,000,000 of outstanding preferred stock on the market today, and I mean today, February 2, 1942?

A. Well, as a matter of fact, I do not know exactly [fol. 7488] what it would be because I have not made the analysis as of yesterday or Saturday or as of this morning but, if refinancing were to take place as of today for a preferred stock exactly similar in all respects to the present preferred stock, I would say that it was someplace in excess of 8 percent and might well approach the 8.5 percent.

Mr. Chamberlain: May I ask whether that means that the participation in dividends would be carried with the new stock?

The Witness: I say, a preferred stock in all respects identical with the preferred stock now standing in the capital structure.

Mr. Chamberlain: That would be participating?

The Witness: Absolutely. It is the same kind of stock to a "T" or to the letter.

By Mr. Littman:—

Q. Now, you are aware of the fact, are you not, that today Panhandle Eastern is receiving bids on a new issue of preferred stock, the proceeds of which will be used, among other things, for the purpose of refunding this \$10,000,000 of outstanding Class A preferred stock?

A. Yes, I am aware of that.

Q. Are you familiar with the terms of that new issue of preferred stock?

A. Some of them. The new stock, among other things, [fol. 7489] is to be a sinking-fund preferred as against this. It is to be a non-participating as against this. When you look at the preferred stock, that is, this proposed new preferred stock, its stipulations and provisions are such that it brings the new preferred a little more in line toward the bond side, let us say, of the capital structure picture than does the presently outstanding preferred stock because of the sinking fund provision more than anything else.

Q. And there is not any question in your mind, is there, Mr. Coffman, that this new issue of preferred stock will cost the company far less than the 8.45 percent or the 7.86 percent which you have used for purposes of your Charts Nos. 37 and 36, respectively?

A. Well, if I can, in answer to your question, leave out the "far less" and just say it will be less, whether it is greater or less, I am not prepared to say, but it will be less.

Q. Now, how much less will remain to be seen. I would like to see myself what the figure is going to be.

Q. Now, the company and the rate payer are entitled to the lower rate if a lower rate is had today?

A. Yes, if they refinance and the new stock is sold and the cost on that new stock is less, why, then we will take that over-all figure into consideration, that is, that figure [fol. 7490] in conjunction with the common stock, obviously, and the bonds.

We will still have to talk about over-all capital structure but giving weight to the figure for the new preferred instead of the one used in this calculation.

Q. Now, suppose this new issue of preferred stock will cost the company $4\frac{1}{2}$ percent. There isn't any question in your mind but that the company and the public and the rate payers are entitled to the benefit of that new rate?

A. No, I would not go quite that far because there is one thing, by your over-simplification, that you are leaving out.

Q. What is that?

A. The common-stockholders of the company at the moment are also going to take a good look at this situation and when they find another security, in addition to the bonds which have sinking fund provisions which again is going to take a portion of the earnings, segregating it for the purpose, the common-stock financing, if it is to be done, might cost more than I have been talking about.

In other words, the sinking fund provisions of the new preferred handicap the common-stockholder to that great extent and you will still have to talk, so far as your customers are concerned, in terms of over-all capital cost and not in terms of one part of the component of the capital.

[fol. 7491] Q. You think, then, that the companies that hold 92 percent of the common stock are going to want more for their money than they have been getting heretofore just because of the refinancing situation that is present today?

A. The holding companies at the present time are not contemplating continuing holding this common stock. They are also having a problem as to what they are going to do so we cannot generalize on that without considering what the possibilities are.

Q. Now, this 12 percent that you have figured as the reasonable rate for common stock will not hold good after today, will it?

A. It may. I want to see the figures first because after you get the figures on the new preferred stock, I do not know what the over-all cost will be. It may be it won't be far out of line at all with this study.

Q. Well, is this study usable today or isn't it?

A. I think it is just as usable as your classical method, absolutely. As long as the results of the classical method will hold up, the results of this study will hold up.

Q. You do not think much of the classical method, do you?

A. Not in and of itself, no, I do not. I think you have to have something in addition to that to make a study.

Q. Can your rate of return be used today?

[fol. 7492] A. Yes, I think it can very definitely. I think it is a very good guide.

Q. What use can we make of this 12 percent that you have fixed for common stock?

A. I say that that is, as of the time of this study, the best appraisal I could make of what the common-stockholders would require and were requiring on the average for an investment of this kind which means should new equity money be sought, it would have to be sold on about that kind of earnings-price ratio.

Q. Can we rely upon this 12-percent figure today after the new financing?

A. I think generally you can but if you cannot rely on this, then I say the results you are getting from your classical method are equally at variance from the facts as this would be so you are up against the proposition of making a new classical method approach with all the costs involved or using this study of getting the costs which are involved which, I think, is less expensive and I think, in many respect, more appropriate.

Q. Now, Mr. Coffman, I simply want to know whether the 12-percent rate for common stock that you have used for purposes of this study may be applied today after the refinancing? Does it still hold good for all practical purposes?

A. I would want to check after the refinancing comes [fol. 7493] out to see. Why should I say that it will or won't when I can have a chance to check it? After all, one fundamental factor has been changed and when any fundamental factor changes it may change the results radically so if you will tell me this noon or this afternoon what the new financing did, it won't be much of a trick to tell you whether this still holds good after we find out what the new financing is.

Q. You are an expert who holds himself out to the public as an adviser in these matters and by your training and study you claim to know what the market conditions are, isn't that correct?

A. That is correct and one of the first fundamentals that I know is that if any fundamental economic factor or factors pertinent to the line of study you are using changes, maybe it won't, but if it does change that calls for a new study to find out and, after all, that is a basic principle with any analyst; it seems to me.

Q. Are you still sponsoring this 12 percent for common stock or are you not?

A. Under the conditions which existed at the time this study was made and under all the factors taken together at the time they were so related, I stick to this 100 percent, yes, sir.

Q. You stick to the 12 percent-100 percent?

A. I certainly do, yes, sir.

[fol. 7494] Q. Have any conditions changed since you made this study that would warrant any change in the use of this 12 percent?

A. Up until this present moment, assuming that the refinancing is not consummated at the moment and a new figure that you might have this afternoon that would change it radically, I would say that this very closely approximates the conditions under which I made the study and the factors as related to each other.

Q. In other words, 12 percent still holds good at the present moment for the common stock assuming no change by reason of the refinancing?

A. And assuming that there has been no radical change in economic conditions which would alter the picture. To my knowledge, no such change at the moment, to date, from the date of this study, has taken place.

In other words, I think if I were to make this study as of today, covering the period from August of last year when the thing was made, I would get at or near the same figure.

Q. What is there about this new financing that might cause you to want to change that 12-percent figure for common stock?

A. I say that the new preferred which is now being offered, among other things, is a sinking-fund preferred [fol. 7495] stock in contrast to the present preferred which has no sinking fund requirement. The new preferred, therefore, so far as the sinking fund is provided, approaches more the classification of a bond and less the classification of a preferred stock.

Such provisions, therefore, create a greater drain on earnings, so far as providing the fund is concerned, to take up at a late date the preferred stock.

Therefore, the common-stockholder to that extent will feel that he is farther removed from a distribution of whatever earnings are left available to his stock.

Q. Now, will you tell us how a sinking-fund provision creates a drain on earnings?

A. Because a sinking-fund provision has to be provided for. In other words, you have to earn money to provide the sinking fund which can be used to apply against the preferred stock the same as you have to provide a sinking fund for the bonds.

For example, \$1,200,000 odd, as I recall it, of bonds are due or rather \$1,250,000 of serial notes are due November 1, 1942. The company, through earnings, must be able to provide that sum so at the due date those notes can be purchased.

Q. Well, your allowance for amortization takes care of all that, doesn't it? You so said in your exhibit.

A. Well, I have taken that into consideration but I [fol. 7496] also said that if earnings come into a company and are reinvested and put into bricks or mortar or otherwise dispensed and you do not get it because of a rate cut or something else and you do not get the cash, it is going to be a little tough to do it.

Q. Well, Mr. Coffman, did you or did you not make a provision for the sinking fund, bonds and preferred stock when you made your allowance of \$2,551,000?

A. Yes, I took the provision into consideration.

Q. Now, in all of the earnings that you provide for in your Charts Nos. 36 and 37, they are earnings after the provision is made for sinking fund, isn't that correct?

A. That is correct.

Q. Now, will you state how the provision in the new issue of preferred stock, the sinking-fund provision in the new issue for preferred stock will affect the common-stockholder adversely?

A. It will affect it to the same extent. You have an additional sinking fund to provide for which I was not providing for when I was making this study.

Q. If you were making this study, do you mean to say you would provide for a sinking fund for amortization over and above the \$2,500,000?

A. I say if the preferred stock comes out and it provides for a sinking fund, that has to be taken into consideration—

Q. (Interposing) How do you mean?

Mr. Wheat: He had not finished his answer.

Mr. Littman: Had you finished your answer?

The Witness: (Continuing) On the basis that I have to have enough in the way of capital requirements, as I see it, to provide the necessary funds so, at the due date of the sinking fund, the payments can be made.

By Mr. Littman:

Q. Will you please refer to a figure in your Exhibit 65 that would be increased by reason of the sinking-fund provision on new preferred stock?

A. The figure that finally would show the amount would be that related to the common stock if investors in the market, that is, common-stock investors in the market, giving full weight to the sinking-fund provisions in the new preferred stock should believe that that was an added additional requirement which might, in some way, enlarge the risk they already have in connection with the equity, if it did, it might be somewhat higher.

If they did not analyze it that way, all right, the figure stands as is. All I am saying is that before I gave the additional figure, I would want to make a calculation to see whether or not there was a change.

I see no difference, in other words, Mr. Littman, between [fol. 7498] having a preferred stock as the present capital stock and issuing new preferred with sinking fund and perhaps enlarging the amount of bonds outstanding.

Now, in the particular case I have assumed refinancing the preferred stock with bonds and common and I have shown had that been done at what I thought were reasonable rates, the amount of money required would have gone down from \$5,064,821 to \$4,993,511, a saving of around \$71,000.

Now, so far as this new preferred stock is concerned, when you make the calculation, it might work out at some saving or it might work out at about \$5,064,000 and that all is due to the fact that certain rates changed as you change the type of security and the percentage in the capital structure represented by either one.

As I say, this afternoon when the rate is available, I think it would be pretty easy to tell whether any major change or material change was effected.

Q. Now, the common-stockholders would get a considerable advantage by reason of the lowering of the cost of servicing the preferred stock from 8.45 percent, which is your estimate, down to something in the vicinity of, let us say, 4½ percent, wouldn't they?

There would be more earnings available to the common-stockholders, would there not, under those circumstances?

A. Well, that will depend on the total number of shares [fol. 7499] that remain outstanding. If there were an equal number of shares and the cost was less than the present cost, there would be some saving to the common-stockholder so far as the earnings' picture is concerned.

But I merely want to add again, on the other hand, that you have got more of a higher class, let's call it, of senior capital because of sinking fund and other protective provisions in the new preferred stock than is the case under the present.

Q. Why didn't you assume such a condition when you undertook to determine the cost at which this money might be refinanced? Weren't you interested in giving the rate payer the benefit of the best possible financing?

A. Sure, and, as I studied the facts, again referring to this exhibit which shows the various companies in the industry and those that have [preferred] stock outstanding

—I referred to that exhibit a minute ago, Chart No. 25— it seemed to me that the facts included in that exhibit, in the first place indicated that, in the natural-gas pipe-line business, it was not the practice to finance by preferred stock and; in the second place, I drew the conclusion from that that apparently the various natural gas pipe-line companies had found, after they had made various considerations, that it did not seem to be the best form of capital to sell.

[fol. 7500] Therefore, I concluded that if there was to be any refinancing of present preferred done, probably the most likely and best basis would be some combination of bonds and common to take care of it and I made that assumption.

Q. Now, Mr. Coffman, I want you to answer this question yes or no. When you made that assumption and when you provided a proposed plan of refinancing of the \$11,000,000 of preferred stock, did you or did you not present the best and most economical refinancing plan that you could conceive of and imagine at the time you presented it? Did you or did you not?

A. I am sorry, I cannot answer that question as you put it.

Q. Do you have some doubts about whether you were doing your best to refinance at the lowest possible rate, Mr. Coffman?

A. I have not said that up to now, to my knowledge.

Q. If you cannot answer the latter question—

A. (Interposing) I can answer—

Q. (Interposing) Suppose you answer in your own way.

A. All right, I will be glad to do that.

As I told you, there have been statements repeatedly made by the S. E. C. in regard to the type of capital structures that ought to be in vogue in companies of this kind and I believe there are numerous references in S. [fol. 7501] E. C. literature to the effect that an ideal structure for this type of business would be one in which there are 40 percent of bonds, 60 percent of common, and that was why I took this particular ratio and also why I called it "ideal".

It was not because I necessarily thought it was the best nor did I make any other calculations to try it.

Q. It certainly was not the lowest cost of money that you could work out considering the market at the time, was it?

A. I would not say on that, Mr. Littman. I do not know. I would not say at all. It might be, it might well be. I do not know.

Q. You mean it is altogether probable that you could have worked out a lower cost of refinancing this \$11,000,000 of preferred stock than that which you presented in your Exhibit 65?

A. I am not too certain of that for this reason:

That, in connection, for example, with the present financing, I have heard, just as hearsay from bankers, [they] they were a little dubious about this issue.

I could have gone on and taken different hypotheses and estimated it on preferred stock all the way from having all bonds down to having a common stock and worked out different figures.

I do not see where, for the life of me, they would have [fol. 7502] been helpful to the study or helpful to the Commission. It did not make them.

Q. You labored and labored and you brought forth the \$70,000-figure?

A. I did not labor. I told you exactly what I did. I relied on the S. E. C. statements and took what they said was an ideal capital structure for this kind of company.

That was not much labor because they had laid it out for me, practically. I took their percentages and laid it out.

Q. Evidently, the company is not following your suggestion of refinancing the \$11,000,000 of outstanding preferred stock by 50 percent bonds and 50 percent common stock and have already secured the Securities and Exchange Commission's approval of the plan of refinancing this preferred stock, by preferred stock, is that a correct statement?

A. The first part of it is correct, that they are obviously not following the plan as I calculated on a refinancing basis.

Secondly, in putting out the issue, they naturally must have had the approval of the S. E. C. and what the results of it will be, I do not know until we see what the market does.

Q. The company is following the plan that will cost them the least in the matter of refinancing this Class A [fol. 7503] preferred stock, isn't that correct?

A. They are hoping they are following that plan.

Q. And the dividend rate on that new issue of preferred stock is $4\frac{1}{2}$ percent? A. That is correct.

[fol. 7504] PAUL B. COFFMAN, a witness, having been previously sworn, resumed the stand and testified further as follows:

Cross-Examination (Continued)

By Mr. Littman:

Q. Do you know, Mr. Coffman, that since April of 1937 various proposals and attempts have been made to refinance Panhandle Eastern's Class A preferred stock?

A. I know, generally, there has been such proposals but I have not analyzed any of them, Mr. Littman, nor am I prepared to say what one is against the other.

Q. But you do know that various proposals and attempts have been made since 1937 to refinance Panhandle Eastern's Class A preferred stock?

A. To say it differently, I know such matter has been under consideration, yes.

Q. Do you know that these attempts to refinance this Class A preferred stock have, from time to time, been blocked by Columbia Oil & Gasoline Corporation, the beneficial owner thereof and also because of certain disputes between Missouri-Kansas Pipe Line Company and Co- [fol. 7505] lumbia Oil & Gasoline Corporation, Panhandle Eastern's parents?

A. I do not know as to the fact that they may have been blocked but I know that there has been some dispute

over a period between the Mo-Kan and Panhandle Eastern.

Q. Let us be more specific with respect to the efforts to refinance this Class A preferred stock. I will read from Page 27 of Exhibit 14-A which is a release issued by the Securities and Exchange Commission, No. 2778 under date of May 28, 1941, the findings and opinion of the Commission in the matters of the Panhandle Eastern Pipe Line Company, Columbia Oil & Gasoline Corporation, Columbia Gas & Electric Corporation:

"Since April of 1937 various proposals have been made to refinance this Class A stock, all of which is held by Columbia Oil. These proposals and attempts to put through such a refinancing have failed—and the history of that failure is a significant indication of Columbia Oil's control over Panhandle Eastern.

"Proposals to refinance the preferred stock made in 1937 were met by Columbia Oil's insistence that the refinancing take place simultaneously with the refunding of Panhandle Eastern's bonds. During 1937 and 1938 it was believed by some of Panhandle Eastern's officers that the condition of the market made necessary a convertible issue of preferred to refinance the outstanding [fol. 7506] preferred. The Mokon interests refused to make any attempts to secure waivers from the minority common stockholders of pre-emptive rights to new common. This, it was claimed, made impossible the issuance of convertible preferred stock—and dampened efforts at refinancing. There was, however, no indication that Columbia Oil would consent to even a convertible issue during the early stages of the refinancing proposal."

Have you ever read that part of the Securities and Exchange opinion?

A. No, I do not recall that I have.

Q. And you were not aware of those facts?

A. Not specifically, no.

Q. I will read on:

"It will be recalled that pursuant to the settlement with the Mokon receivers, rights to 80 shares of Panhandle Eastern's common stock were to be distributed to Mokon stockholders. During the early part of 1939

hearings in the Delaware Chancery Court were being held on the question of this distribution. Because of the pendency of this proceeding the Panhandle Eastern Board, on January 25, 1939, abandoned plans for selling convertible preferred stock. The alleged reason was that the outcome of the proceedings had a vital bearing on the type of financing which it was possible to do at that time.

"On June 21, 1939, the Delaware Chancellor ordered a [fol. 7507] distribution of the 80,000 shares of Panhandle Eastern's common stock to Mokan stockholders. The tension was broken. A substantial block of stock in the hands of an adversary had been smashed, and in July of 1939 the Finance Committee of Panhandle Eastern was ready to recommend continuation of negotiations with Kuhn, Loeb & Co. for a 4½% cumulative preferred stock without a conversion feature."

"Have you familiarized yourself with those facts, Mr. Coffman?"

A. No, not for purposes of this study.

Q. I read on:

"It is apparent that up to this time the dominant factor in the timing of the action of the Panhandle Eastern Board was the relative control positions of Columbia Oil and Mokan. The distribution of a strategic block of stock was the 'vital' factor in 'the type of financing which it was possible to do at that time'. When the block was broken it became 'apparent', according to the testimony of Sperry, Treasurer of Panhandle Eastern 'that we could sell an issue without the conversion privilege attached'.

"But a new barrier was presented. On August 7, 1939, Creveling, president of Panhandle Eastern and chairman of its board, reported that Columbia Oil had determined that the pendency of the plan of divestiture before the Federal Court made plans for refinancing 'premature'." [fol. 7508] Have you familiarized yourself with those facts?"

A. Not for purposes of this study, No.

Q. Did you know about these facts?"

A. I knew generally about them, yes, but I made no detailed study nor gave weight to them because it was not pertinent for the study at hand.

Q. In your opinion? A. In my opinion, yes.

Q. I read on:

"Panhandle Eastern tried again, in what was deemed a reviving market, in November of 1939. This time negotiations were undertaken for a joint refunding of the bonds and refinancing of the preferred (the action previously recommended by Columbia Oil) with Kidder, Peabody & Company and Gore, Forgan & Company. On December 28, 1939, the Panhandle Eastern directors recommended to Gano Dunn a program of refunding and retirement. On January 19, 1940, Gano Dunn conveyed to the board of Panhandle Eastern the sentiments of Columbia Oil: Columbia was unwilling to consider, at that time, the refinancing of the preferred stock. This ended Panhandle Eastern's efforts at refinancing. Panhandle Eastern in the face of a market which it appears would have absorbed a refinancing at 4½% is still saddled with a 6% cumulative, participating preferred stock which paid in 1940 a dividend of 10%, and which, according to [fol. 7509] its terms, after June 1, 1941, would cost the company a premium of \$1,000,000 should it attempt a refinancing."

Were you aware of these latter facts which I have just read? A. Generally.

Q. Did you give those facts any weight in the making of your study which is contained in Exhibit 65 for purposes of this proceeding?

A. No, I did not give those any weight, as I think I have clearly indicated in my testimony.

Q. You understand, do you not, that some nicknames are used for purposes of brevity in this opinion.

For instance, the name "Mokan" refers to Missouri-Kansas Pipe Line Company; the name "Columbia Oil" refers to Columbia Oil & Gasoline Corporation; and that "Panhandle Eastern" refers to Panhandle Eastern Pipe Line Company.

You understand that, do you?

A: I understand that, yes.

Q: And I believe you have already testified late this morning that the dividend rate on the new issue of preferred stock, the proceeds of which are expected to be used to refund the \$10,000,000 of Class A preferred stock presently outstanding, is 4½ percent?

A: Well, I think, generally, that is the case although in the particular proposed financing, I think there was [fol. 7510] not an exact determination but the matter was to be determined in accordance with bids to be submitted.

Q: Well, of course, the bids in the ultimate will determine the actual cost of money? A: Yes.

[fol. 7512] By Mr. Littman:

Q: Will you please turn to your table for Chart No. 37, Mr. Coffman. In your table for Chart No. 37, you show in the right-hand column the amount of \$3,510,995 as "Balance for common stock (after participation of Class A preferred stock)", do you not?

A: Yes, I do.

Q: Now, that represents the 12-percent earnings-price ratio on common stock and surplus as of June 30, 1941, of \$29,258,295, is that correct?

A: Yes, that is correct.

Q: Now, is my understanding correct that that is the amount which the common-stockholders will eventually receive under your projected assumption which is headed at the top of the column, "Projected assuming present preferred stock remains outstanding"?

A: Not just as you state your question, Mr. Littman. That is the earnings-price ratio that I say is required under conditions existing at the time of the study by the prospective investor and, as I have pointed out on numerous occasions, whether or not he receives that amount [fol. 7513] is going to depend upon dividend policy.

Q: Well, under the assumption that you make that conditions will not be changed, let's put that aside. How much of this amount would be paid in dividends over the life of the company to the holders of the common stock?

A: Well, it is difficult to answer that, because, as I have pointed out throughout, the earnings that the company makes or produces flow through the cash account

which is, in turn, reinvested and this being a growing company, it will be determined by the management what they believe they can reasonably pay out of these earnings, the remainder being retained in the business for operating purposes.

I do not know. If it were in the present status and in a liquidating process, if there was no drainage on those earnings, the entire amount should be available for distribution.

Q. Eventually to the common stockholders?

A. Well, if you will take the statement exactly as I have made it. The money is there but that is a hypothesis which does not exist because this is a going concern and as I have said, hour by hour these earnings are being reinvested in the business so whether or not they will be distributed, is quite a long shot. I do not know.

This is a business with a wasting asset. If you continue to reinvest the money in that situation, I have not [fol. 7514] any idea but the common stockholder will wind up with very little in this business before he gets through with it.

Q. Well, it is apparent, isn't it, Mr. Coffman, that under the assumptions which are shown in your Chart No. 37, if anything less than \$3,510,995 goes to the common stockholders of Panhandle Eastern, such stockholders would not receive fully 12 percent on the invested capital?

A. That is correct.

Q. So that in order to get the 12 percent that you say the common stockholder must have, it would be necessary for Panhandle Eastern to pay out to the stockholders this \$3,510,995, isn't that correct, under the assumptions that you have made for purposes of your study?

A. If the full amount of earnings available is to be distributed, the answer is yes, but the calculation here, you must distinguish on the basis that it is an earnings-price ratio and as long as the earnings are there, the management if efficient, all corporate policies are reasonable, he will take, in the meanwhile, something less in the way of dividends, not worrying about the amount that

is retained in the business if the conditions I have just enumerated hold true over the history.

Q. If it is plowed back in the business, it would merely enhance the common-stockholder's equity to that extent, would it not?

[fol. 7515] A. That would be true providing all other things remain equal.

Q. But in order for the common-stockholder to earn 12 percent, he would have to receive this amount of \$3,510,995, is that right?

A. Well, no, your language is confusing there. The company can earn it for the benefit of the stockholders and it is 12 percent.

I did not say that he received it. All I said is that the earnings in that amount must be there. Whether or not the stockholder is to receive that remains to be seen and depends upon corporate dividend policy and we have got to distinguish between those two things.

He will never receive it until it is paid to him even though it is recorded on the books.

Q. Theoretically, it is going to be paid to him under your hypothesis?

A. It is presumed the money—no, I will retract that statement.

It is presumed that the earnings were made and they were converted into cash which, in turn, has been re-invested in the business.

Now, if the business continues on the same kind of earnings basis henceforth, that it was at the time, presumably that ratio will hold good but that is the hazard. [fol. 7516] Whether or not it will operate that way in the future remains to be seen because, as I have tried to point out time and again here, being a wasting asset, costs and other expenses go up and I do not know whether he will bail out or not and it is a fallacious assumption to assume any such thing.

Q. Assuming a static condition and no changing events in the future, under your study and your hypothesis and your assumptions, he would eventually get this \$3,510,955 a year, would he not?

A. If all conditions remained absolutely the same, it will be in the company available to him. I want to draw that distinction.

When you get it you get the cash when it is earned. If it is retained in the business, it is available but until it is paid, the stockholder has not received it.

Q. How about 25 years hence when, according to your assumption, the business will be wound up by reason of the exhaustion of the gas supply? Will he get it then?

A. I doubt very much whether he will get it, Mr. Littman, and I will cite you a specific example.

The very thing you read to me sometime back on Southern Natural proves the point. Southern Natural, as I understand what you read, says that at the beginning of certain operations they estimated the length of life of [fol. 7517] reserves to be so many years.

Now, under a recent investigation, they find that at peak loads their present reserves will last four to five years. At the present time, instead of confessing to their stockholders who put in this original money to buy these reserves, that that particular phase of the business will be ended, according to best estimates now at the end of four and five years, and getting themselves into position so they can liquidate for whatever they can net, the management informs the investors and the public and also the Commission that it is now looking around for additional sources of gas supply and they admit that such gas is going to cost them about 11½ cents per M.c.f. more than their present gas reserves so they are taking earnings, such as they are, into cash, reinvesting that cash in a higher-cost reserve and gas supply, and so on, and I presume they are going to operate until there aren't any more available gas supplies and it is my contention if that company keeps on on that basis, there is no way that the company can possibly wind up at the end of time with sufficient money to pay off those securities and the same thing applies to the Panhandle Eastern Pipe Line Company.

Q. Let me be perfectly clear about this, Mr. Coffman. Is that what you had in mind when you fixed the 12 per-

cent rate of cost of money for common stock of Panhandle [fol. 7518] Eastern?

A. No, I did not say that. I have told you exactly.

Q. Why talk about it then?

A. Because it is a point in case in the question you asked me.

Q. Does your estimated cost of common-stock money reflect the situation which you have just described or doesn't it? It either does or it does not.

A. It represents just what I have stated it to represent.

Q. Will you answer my question? It either does or it does not, clearly.

A. I am sorry I cannot answer your question that way, Mr. Littman.

Q. You are stating now you cannot tell me whether or not your estimate does or does not reflect the situation which you have just described with respect to Southern Natural Gas Company?

A. I cannot answer that except in my own language and my language is this, if you want to have my answer:

That the 12 percent, as we know, was based upon an estimated life of 25 years for the reserves. As I have pointed out, that earnings' ratio is for earnings solely. The dividend policy is something else.

To the extent that the earnings available under these [fol. 7519] calculations are retained in the business, they are reinvested there and to the extent, over the years, that the management of this company will feel called upon or believe it wise to make new contracts, new leases for acreage, they are going to find the same situation —

Mr. Wheat: (Interposing) The same situation as what?

The Witness: (Continuing) The same situation as Southern Natural Gas Pipe Line Company and that is a matter of business operations.

By Mr. Littman.

Q. In other words, you have provided a sufficient cushion with which to bail out Panhandle Eastern from the same kind of a jam in which Southern Natural now finds itself?

A. No, not at all, Mr. Littman, not at all. That is one question I can answer yes or no and the answer is no.

Q. Well, you said a moment ago, if I correctly understood you, that you expected Panhandle Eastern to experience the same type of difficulty that Southern Natural has experienced or didn't you say that?

A. No, I did not say that. I said if this company with these earnings finds, over the history, that they have the same kind of a situation before it and, therefore, take these earnings and reinvest them in the business, I do not see how even with this figure you can bail a security holder out because the money would not be there. That [fol. 7520] is all I have said.

Now, if we are going to provide for that, then I would have to make a further allowance so it is up to the management of this company to so conduct its business that it can, with these earnings, pay off.

Q. Let's have the amount of further allowance that would be necessary for the situation that you are either expecting or afraid of?

A. I do not need any allowance, Mr. Littman. I believe under the present intention even, that I understand you are making, that the only sound way that this could be done is to say to a company like Southern Natural Gas Pipe Line Company, "If you arrive at a point or are now at a point where you are telling the consuming public and the investors that you must go out and make a new deal, get new resources, you get new financing and set up a new separate organization to do that but do not confuse it with what you have already sold to the investing public and have told the customers you have."

On that basis, it may be we could get this thing straightened out.

Q. You certainly succeeded in confusing me and I would like to be cleared up on this. Let me put it this way:

Is it your testimony that the common-stockholders of Panhandle Eastern will not receive the \$3,510,995 which [fol. 7521] is, under your Chart No. 37, available to the holders of the common stock for each year?

A. I say that if the company finds itself, over its history, in a situation such as Southern Natural finds itself

presently and this company follows exactly the same procedure as Southern Natural is following, the likelihood is that at the end of time on Panhandle Eastern, there just would not be enough assets there to pay this off. That is exactly what I am saying.

Q. Now, would you mind answering my question. I think it can be answered yes or no. If you cannot answer that yes or no, I wish you would please state so.

Suppose you read it back, please.

(Whereupon, the question indicated was read by the reporter.)

The Witness: I stick with my answer.

By Mr. Littman.

Q. You cannot answer that yes or no? A. No.

Q. Do you know what use this Commission can make of this figure if we do not know that assumption—

A. (Interposing) Yes.

Q. (Continuing) If we do not know the answer to that question? A. Very definitely.

[fol. 7522] Q. Suppose you tell us what use might be made of this figure of \$3,510,995? What are we going to do with it?

A. You are going to add that to the other two items that I have referred to, one on preferred stock and the other on the bonds, to get the total of \$5,064,821 as shown in Chart No. 37 of Exhibit 65 as the amount in dollars the company must receive for capital requirements if the market is to be forthcoming for public financing and under the conditions or conditions similar to what existed at the time the study was made.

Q. All right. How much of it is going to be received by the common-stock holder?

A. The amount that was allowed for common is \$3,510,995.

Q. How much of that amount is the common-stock holder going to receive?

A. I do not know until they talk about dividends. I haven't the slightest idea.

Q. You cannot tell us, then, what the common-stock holder expects to actually receive?

A. That dividend policy is purely a management proposition.

Q. You cannot state what the common-stockholder expects to receive upon his investment in Panhandle Eastern Pipe Line Company?

[fol. 7523] A. No more than I have shown in the calculations I made in table to Chart No. 37.

Q. Where have you shown how much the stockholder is going to receive?

A. It is included in the \$3,510,995.

Q. Well, let's get at it this way:

Are the common-stockholders going to receive \$100 of that \$3,510,995 a year? Are they going to receive \$200, \$1,000,000, are they going to receive \$2,000,000? How much?

A. It is shown in the calculation where I have made an estimate for what the participations for the preferred stock was, based on a \$2.50 annual dividend on the 807,367 shares of common stock.

Q. Is that the dividend which you expect—

A. (Interposing) That was the dividend I used for this calculation.

Q. You used it for a calculation but do you expect the common-stockholders to receive a dividend of \$2.50 per share on their common stock?

A. Under the conditions that I analyzed here at the time, it seemed to me that was a reasonable expectancy.

Now, if there is a rate cut or if there is a substantial jump in some cost or some other factor, I do not know. The management will have to meet that as it comes and it seems to me the Commission will, too.

[fol. 7524] Q. What, in your opinion, is the common-stockholder going to require before he invests his money in the common stock of Panhandle Eastern?

A. At the time this was made, he required the earnings-price ratio of 12 and he received a \$2.50 dividend actually.

Q. 92 percent of those common-stockholders were the two parent companies of Panhandle Eastern, namely, Columbia Oil & Gasoline Corporation and Missouri-Kansas Pipe Line Company, is that right?

A. Well, yes, the great majority of the common stock was split between Missouri-Kansas Pipe Line and the Columbia Oil and Gasoline Company.

Q. Now, you have in the left column of figures in your table for Chart No. 37 an amount of \$1,388,480 which you term "Preferred dividend requirements (based on maximum participation of Class A preferred stock)".

Now, what is that?

A. Well, those figures in the left-hand column are the actual figures for the 12 months ended June 30, 1941. I mean I just took those right from the statement.

Q. Are you stating that Panhandle Eastern Pipe Line Company paid \$1,388,480 to the preferred stockholders for the year ended June 30, 1941?

A. No, I think that calculation is based upon allowing the maximum participation on the earnings available in [fol. 7525] order to see what would be left for common.

Q. That is not an actual figure at all?

A. That figure is not actual but that is to find out what share would be available to common if you distributed all of the earnings so that you had to work out your participation as between the preferred and common for everything over \$1.50.

Q. What was the purpose of making that calculation?

A. Well, it is based upon your own question, I think, as to what earnings are necessary if you are going to calculate what the investor needs and add that into the other expenses to get a total dollar needed.

Q. You assumed, for purposes of your study, that the common stockholders would receive a dividend of \$2.50 per share on each share of common stock?

A. Yes, that is correct.

Q. And you consider that a reasonable assumption?

A. Under the facts at the date of this study, I thought that was a reasonable assumption, yes.

Q. What was the market value of Panhandle Eastern's common stock as of approximately June 30, 1941, per share? I believe that is shown in your table for Chart No. 20.

A. As I recall it, it was \$36.50.

Q. Yes, that is the figure shown as the "average market price, January 1-August 31, 1941" in your table for [fol. 7526] Chart No. 20.

A. Yes.

Q. Now, on that basis, namely, the basis of receiving a \$2.50 dividend per year, what would be the rate of earnings for the common-stockholder on each share of Panhandle Eastern's common stock?

A. You mean rate of dividend?

Q. Yes, the percentage rate of dividend. It is 6.85 percent, I believe.

A. It is about 6.8 percent.

Q. Under the assumptions that you have made for purposes of Chart No. 37, to-wit, the assumption of a \$2.50 dividend per share of common stock, the yield to the common-stockholder would be 6.8 percent?

A. That is correct, on the figure we have.

Q. And he would leave the difference between 6.8 percent and 12 percent, namely, 5.2 percent, with the company?

A. Well, he is forced to leave it with the company if they do not pay it out, yes.

Q. In your opinion, under the conditions which you have assumed for purposes of your study, Exhibit No. 65, would the common-stockholders of Panhandle Eastern be satisfied with a yield of 6.85 percent?

A. They probably would so long as the earnings ratio remained at 12 percent.

[fol. 7527] Q. Now, in the David Young III, suit, to which reference has heretofore been made, you testified that 80 percent of the earnings available to the common-stockholders would be paid in dividends, is that correct, on the average?

A. Not quite that way. What I did, because of this participation feature, I had to take the earnings available to both preferred and common and took 80 percent of that.

In other words, since there was that participation feature, I had to first see how much was over-all available so that the more accurate statement is the one I gave you rather than the one you used.

Q. Now, assuming that 80 percent of the earnings available for common stock may be properly distributable by way of dividends to the common-stockholders, then, in order for the common-stockholders to get this 6.8 percent

yield, the actual earnings would be, under that assumption, 8.56 percent, wouldn't they, instead of 12 percent?

A. Well, I do not know. I have not made that calculation but that really does not mean anything.

Q. Suppose you make it. I am asking you to assume that you are setting aside 80 percent of the earnings for dividends which is what you did in the David Young suit and calculate for me and check my figure of 8.56 percent as the earnings that would be required to yield 6.85 percent to the investor.

[fol. 7528] Mr. Wheat: You are asking the witness merely to check the mathematics of your figures?

Mr. Littman: I am asking him to tell me whether the figure I gave him is correct under the assumptions that I made which are the assumptions which he made in the David Young III; suit.

Mr. Wheat: I am trying to get straight, Mr. Littman, on this. Did you say something about 80 percent of the common stock or 80 percent of net income?

Mr. Littman: 80 percent of the earnings available for the common stock.

Mr. Wheat: That is your assumption.

Mr. Littman: The witness does not seem to have any difficulty.

Mr. Wheat: Mr. Littman, I want to get this straight. You said to me, "I asked him to make an assumption which was an assumption in some other case".

I am asking you merely whether this is your assumption. You combined two things in that which I am advised are erroneous and I want the record to show it.

Mr. Littman: I think your confusion flows—

Mr. Wheat: (Interposing) I am not confused, Mr. Littman, at all.

Mr. Littman: (Continuing)—from your lack of knowledge of this witness' testimony in the David Young case.

[fol. 7529] By Mr. Littman:

Q. What do you find by that calculation?

A. I want to get you to say where you got that 5.8 figure. I have not yet gotten that figure.

Q. The figure I asked you to check was 8.56 percent.

A. No, that is not the figure you gave me first, is it? Let me have this read back. I do not remember that figure at all.

(Whereupon, the portion of the record indicated was read by the reporter.)

By Mr. Littman:

Q. You understand my question, don't you, Mr. Coffman?

A. As I understand it, you want me to take the earnings that I have here, assume a distribution of 80 percent and then calculate the amount, is that right?

Q. I asked you to state the percentage of earnings available for common stock that would be required to produce a yield to the common stockholder of 6.85 percent if 80 percent of the earnings available for the common stock were paid out in dividends.

I believe your answer will be 8.56 percent because 80 percent of 8.56 percent gives 6.85 percent which is the yield to the common stockholder based on an 80 percent of earnings yield.

[fol. 7530] A. I will grant you that 80 percent of 8.56 percent is 6.85 percent but until I went back and found out the earnings that were available and calculated the participation, I would rather see the dollar figure and see if that calculation gives 6.85 percent.

Q. Let me put it this way:

You have already answered my question but in order to clear up the record, I think it might be well to go over the calculation again.

Assume that a hypothetical company has earnings available for its common stock of 8.56 percent.

Mr. Culton: Is that a company that has no preferred stock?

Mr. Littman: I am asking him to assume a hypothetical company.

Mr. Culton: You said available for common stock.

By Mr. Littman:

Q. Suppose we continue. Assume that this hypothetical company is paying out 80 percent of its earnings available to common stock to its common-stockholders by way of dividends.

Query: What would be the yield to the common-stockholder on those assumptions?

A. Well, on that assumption which I indicate has no participation feature or anything else but is just straight [fol. 7531] common, then you could apply 80 percent of 8.56 percent which would be 6.848 percent.

Q. And that 6.8 percent is the amount with which you assumed the common-stockholder would be satisfied if he were a common-stockholder of Panhandle Eastern under the assumptions which you have made for purposes of your Chart No. 37 in your Exhibit 65, isn't that right?

A. No, I do not follow that. That was the assumption that I made in the David Young suit which was two or three years ago.

Q. Didn't you testify a few minutes ago, Mr. Coffman, that you assumed the dividend would be paid on the common stock of \$2.50 a share?

A. Yes, I assumed that but I did not say that was 80 percent of anything.

Q. Now, let's go from there. That \$2.50 dividend on Panhandle Eastern's common stock which had a market value as of the first 8 months of 1941 of \$36.50 represented a yield to the common-stockholder of 6.8 percent, isn't that correct? You just said so a few minutes ago.

A. Maybe I did. I do not recall the figure. If that is what I said, it is correct, or I will recalculate it again.

Q. It is 6.8 percent.

A. All right. It is 6.85 percent.

[fol. 7532] The Witness: Mr. Littman, I believe that there is a possibility here that on your question I misunderstood you in your last question.

If I understood what you said, I will stay by the answer I have given. On the other hand, if I did not understand it, I would like to make a further point, so may I have the question and answer read back to see if my understanding is correct.

(Whereupon, the portion of the record indicated was read by the reporter.)

The Witness: The only point that I want to get correct is that I had thought that someplace in the assumption Mr. Littman had then said that is what I did in the David Young suit.

Mr. Wheat: I think you will find his assumption in the first question involving it. That is when I interrupted, so to speak.

The Witness: Well, at that point I thought I had said that in the David Young suit I had taken 80 percent of the earnings available for both preferred and common because of that participation feature and that statement is correct; but if you are going to confine the situation to the [fol. 7533] common stock only and still talk about the David Young suit, the percentage was not 80 percent but for the common would have been figured at 74.8 percent because, in the David Young suit, my 80 percent applies to the earnings available for preferred and common.

If we are clear on that point, I will stick by my answer. It is perfectly accurate. I do not know whether I still get my point across.

By Mr. Littman:

Q. The last point just preceding the recess which I was endeavoring to ascertain was simply this:

Whether you considered the dividend payment of \$2.50 per share on the common stock of Panhandle Eastern Pipe Line Company to be reasonable under the circumstances?

A. As of the date of this study and our present testimony, I assume that \$2.50 was a reasonable dividend and so made my calculations upon that basis, so far as the common stock is concerned, yes, sir.

Q. It is clear that that \$2.50 per share dividend on the common stock of Panhandle Eastern would be equivalent to 6 point—

A. (Interposing) —849.

Q. 6.849 percent?

A. On a price of \$36.50 for the common stock.

[fol. 7534] Q. Which was the market price as of 1941?

A. Which was the market price as of 1941, yes, sir.

Q. That was what I wanted to make certain was clear in the record. A. That is, all right.

Q. Will you please turn to Chart No. 30 of Exhibit No. 65.

In this chart, you have allowed for an increase in Federal taxes owing to the higher rates in the Revenue Act of 1941 over those in effect during the year 1940, is that correct?

A. Yes, sir.

Q. Now, that estimated increase owing to higher rates in the Revenue Act of 1941 is applicable wholly and solely to the rate itself, is that right, that is, the increase in the rate itself?

A. Well, it includes that. As I think I have explained earlier, I took the actual 12-months' figures ended June 30, 1941, which were \$3,008,117 and allowed a 10-percent increase generally, and the way I arrived at that was a calculation I had made before which is shown in Chart No. 15 where, on the basis of the calculation I made, I applied to the same base the 1940 rate and then next the 1941 rate, indicated that the difference in dollars was about a million dollars in taxes by way of increase as against what you [fol. 7535] have at the present time.

In other words, what I was trying to ascertain was how much difference had been created by a change in tax rates with no other change.

Q. Now, on top of that, you made a further allowance of a 10-percent increase in Federal taxes to cover the projected period after June 30, 1941, as shown in Chart No. 30, is that correct?

A. That is correct, with the trend of taxes what they were, it was a reasonable expectancy that the increase would amount to at least 10 percent over-all.

Q. Now, you are speaking of a 10-percent increase in the tax rate?

A. Well there, I am speaking of 10 percent as applied to a dollar amount. In other words, I felt that the trend in tax rates was such that, in a reasonable period, a figure of 10 percent applied would give a close approximation of what the specific increase in rates would account for as taxes continue to go up.

Q. It was intended to cover an increase in rate?

A. That is correct without saying specifically the rate, because there again you have your access profits as well as your normal rate.

The two rates will be different so I talked in terms of aggregate dollar and said an allowance of 10 percent over [fol. 7536] all would closely approximate what you could reasonably see in the near future in the way of increase.

Q. And would take care of an increase in the rate?

A. That is correct, not saying what that particular tax rate might be.

Q. Yes. It was intended to give you a general approximation of the effect of an increase in tax rates in 1941 over those which were actually secured by calculating by the use of the 1941 Revenue Act rates, isn't that right?

A. Revenue Act rates plus expectancy and I tried to support that further by that supplemental Exhibit No. 152.

Q. Now, I would like to have you refer, Mr. Coffman, to Exhibit No. 147 which is the Securities and Exchange Commission's findings and opinion in connection with the financing by Panhandle Eastern.

I would like to have you turn to Page 17 of that opinion and refer to the present and pro forma consolidated capitalization of Panhandle Eastern as of September 30, 1941.

A. Yes, I have that.

Q. Do you find that? A. Yes.

Q. Now, you have been speaking from time to time throughout your testimony about changing conditions and the purpose of my present line of inquiry is to ascertain the [fol. 7537] effect of changed conditions, since you made your study, upon your conclusions reached in Exhibit No. 65.

Now, the first thing shown in this consolidated pro forma statement under the heading, "Funded debt" is the first mortgage, Series A, 1946-1950, in the "actual amount" of \$6,250,000.

That represents the principal amount of the total outstanding bonds of that class as of September 30, 1941; does it not?

A. It does.

Q. On the pro forma side, you observe, do you not, that this amount will remain the same after the new financing, as well as before? A. Yes, that is true.

Q. The second class of funded debt is called, "First mortgage, Series B, SF 3's, 1960, in the "actual amount" of \$12,000,000 and in the "pro forma, amount" of \$12,000,000. A. That is correct.

Q. You understand that represents the existing bonds of that class that are presently outstanding? A. Yes, sir.

Q. Now, thus far we have no changed conditions with respect to those bonds, have we?

A. That is correct, so far as the bonds are concerned.

Q. Now, let's skip the next one for the time being and [fol. 7538] let's go down to the "serial notes, 1942-1945."

The actual amount outstanding before and after the financing is \$5,000,000 principal amount, is that right?

A. That is correct.

Q. The last item under funded debt is "leasehold purchase obligation", \$14,256 which is the same before and after the capitalization. Do you find that?

A. Yes, that is correct.

Q. Now, the total of those four items which I have read is \$23,264,256 which is virtually the same as the total for the funded debt outstanding as of the time you made your study as of June 30, 1941; isn't that correct?

A. The amount outstanding as of the date of my study is shown in Chart No. 26, Exhibit C, and is \$23,267,544 which closely approximates the figure contained in Exhibit No. 147 to which you now have me refer.

Q. Now, the only change is a slight reduction in connection with the leasehold purchase obligation which, at the time you made your study, amounted to \$17,544 and which, as of September 30, 1941, was \$14,256. Isn't that the only item that accounts for the difference?

A. Yes, that is correct.

Q. Now, will you please refer to your table for Chart No. 26. In that table you show that the earnings requirement to service the outstanding long-term debt was \$637,531, isn't that correct? A. Yes, that is correct.

[fol. 7539] Q. Now, in so far as that amount is concerned, there has been no change since you made your study, that is, there will be no change even after the refinancing?

A. Practically none because of the reason given that there has been a very slight change in the meanwhile.

Q. We may therefore conclude, for all practical purposes, that the earnings requirement for the four classes of funded debt to which I have referred and which will remain outstanding after as well as before the refinancing, will be \$637,531, may we not?

A. So far as those particular issues are concerned; yes.

Q. All right.

Now, note on the pro forma side of the statement of the S. E. C. on Page 17 of its opinion that there is a new issue of first mortgage, Series C, sinking fund bonds carrying a 3 percent coupon rate due 1962 in the amount of \$10,000,000 which is proposed to be issued. Do you find that?

A. Yes, I do.

Q. Now, I believe Mr. Wheat has stated earlier this afternoon that the bid received in New York this morning on those bonds indicated that the cost or the yield would be 3 percent.

[fol. 5540] A. That is correct.

Q. Now, the capital requirements on that basis for the new \$10,000,000 of first mortgage, Series C bonds, is \$300,000 per year, is it not? A. That is correct.

Q. Now, that \$300,000 added to your \$637,531 produces a total earnings requirement for the outstanding funded debt after the refinancing, of \$937,531 per annum, isn't that right? A. Yes; that is right.

Q. And thus far, we have taken care of the changed conditions with respect to the capitalization of Panhandle Eastern, have we not? A. That is correct.

Q. That is, so far as bonds are concerned.

A. So far as the bonds are concerned.

Q. Now, the next item on Page 1 of the Securities and Exchange Commission opinion, Exhibit No. 147, is preferred stock.

You will note that the second item, "Class B" in the amount of \$1,000,000 remains the same after, as well as before, the refinancing, does it not?

A. It does.

Q. And that Class B Stock, as has been heretofore explained, carries with it a straight 6 percent cumulative [fol. 7541] preferred dividend, does it not?

A. Yes, it does.

Q. And the earnings requirement for that Class B preferred stock is \$60,000 per year, is it not?

A. That is correct.

Q. So we have no changed conditions in so far as Class B preferred stocks are concerned, isn't that correct?

A. That is correct.

Q. I note under the heading, "Preferred stock", that the Class A preferred stock, concerning which we have had much comment this morning, in the principal amount of \$10,000,000, is to be retired.

Do you see that?

A. That is correct.

Q. So we do have a changed condition with respect to the Class A preferred stock, isn't that right?

A. That is right.

Q. You understand, do you not, that a new series of cumulative preferred stock in the amount of \$15,000,000 is to be issued and that out of the proceeds of that sale, the old Class A preferred will be retired. You understand that, do you not?

A. Yes, of course, we are talking about the same stock. The new stock is not only cumulative but it has a sinking fund, and so forth.

[fol. 7542] Q. It has a sinking fund provision?

A. That is right and there is a new preferred stock to be issued to pay off or to refund the old preferred, and so forth.

Q. But the new preferred stock does not have a participating dividend provision, does it? A. That is correct.

Q. In other words, the holders of the new preferred stock will not have any right to participate in the dividends of the common stockholders? A. Yes, sir.

Q. And you see that amount of \$15,000,000 on the pro forma side of the statement, do you not? A. Yes, I do.

Q. Now, Mr. Wheat has stated that he was advised by telephone that the cost of that money was 5.6 percent. Accepting that figure, will you please compute the earnings requirement annually to service the new cumulative preferred stock? A. That is \$840,000.

Q. Now, so far, we have taken care of the changed conditions with respect to the preferred stock, have we not?

A. And the bonds.

Q. And the bonds. A. Yes.

[fol. 7543] Q. Now, let us go to the common stock and surplus.

Here, we have the same amount of common stock outstanding before, as well as after, the refinancing, namely, 807,367 shares, is that right?

A. That is correct.

Q. And the surplus is the same before and after refinancing, is it not, as shown on the Securities and Exchange Commission's statement? A. That is correct.

Q. Now, if you will refer to your table for Chart No. 26, you will observe that the total common stock and surplus outstanding as of June 30, 1941, there shown was \$29,258,295 whereas, on September 30, 1941, the total had become \$26,507,216 as shown by the Securities and Exchange Commission's opinion, is that correct? A. That is correct.

Q. So we do have a change in conditions between the date of June 30, 1941, and September 30, 1941, is that right?

A. That is correct, on that particular item, of course.

Q. Yes.

Mr. Coffman, if the common-stock holders of Panhandle Eastern will continue to be satisfied with a \$2.50 dividend per share of common stock which, as you have testified, means a 6.8 percent yield to them, what would be the indicated earnings requirement for the common-stockholders [fol. 7544] on that basis?

A. Well, in round figures it would be \$2,522,897.

Q. May I have that figure again?

A. \$2,522,897. That is in round figures.

Q. Will you please state how you obtained that figure?

A. On your statement of the problem, I took the 807,367 shares which were outstanding of common stock and multiplied that figure by \$2.50 which is the dividend rate that you stated, which gave me \$2,018,317.50 which is the dividend assumed to be paid and on the basis of the rate which you used which is equivalent to 80 percent, I assumed that that figure represented 80 percent of the earnings available

which would be \$2,522,897 of the total earnings on your hypothesis.

Q. That would be the total earnings available or, stated in another way, that would be the total earnings-requirement if we were to use the method suggested by you in the David Young, III, suit, wouldn't it?

A. Jimmy Christmas, no, Mr. Littman!

I guess I still haven't got the point across because in the David Young case, I was talking about 80 percent of the earnings available from preferred and common.

I cannot state it any more clearly than that. It was not [fol. 7545] 80 percent of the earnings available to common. That, as I told you, was 74.8 percent so if you will stop confusing the David Young case, I might be able to answer you a little more directly.

Q. Well, at any rate, on the assumption that the stockholders of Panhandle Eastern would continue to be satisfied with the \$2.50 per share dividend which was your own assumption in this proceeding and on the assumption that 80 percent of the earnings could be properly used for dividend purposes, you get an earnings-requirement of \$2,522,897 under those assumptions?

A. Under those assumptions you get a total earnings available of \$2,522,897, that is correct.

Q. Now, for purposes of your Exhibit No. 65, you use a 12 percent earnings requirement for both the common stock and the surplus, do you not? A. That is correct.

Q. And that would be the figure under your assumption to use for our purpose here, would it not?

A. Well, you still, on your basis in this particular case, have not considered the surplus figure at all.

Q. I am stating—

A. (Interposing) Excluding the surplus, your statement is correct but that is not the method that I used in this proceeding because, as you know, I took both common [fol. 7546] stock and surplus on the theory that the surplus available to the common remained invested in the business or otherwise it would not be on the books.

Q. Well, on your assumption, it would be fair, would it not, in your own mind, to use 12 percent as the basis of the determination of the earnings requirements for the common stock and earned surplus shown in the Securities

and Exchange Commission's statement on Page 17 of its opinion?

A. Accepting the conditions in the investor market as shown in my present Exhibit 65, I would have to use 12 percent. If conditions presently in the market on the common stock of Panhandle Eastern should show a change because investors appraise this new situation which has just now come to light at 12 noon today, then I would have to take into consideration the changed price and see what effect, if any, that made and follow the same procedure in those calculations that I have here but not having those calculations at the moment, I would say that 12 percent still approximated the percent to be used.

Q. The 12-percent rate still represents your best judgment at this time?

A. It still represents my best judgment at this time, that is correct.

Q. That is to say, there have occurred no changes in [fol. 7547] the money-market situation of which you presently have knowledge which would cause you to change the 12-percent figure now?

A. Generally, not that I know of, Mr. Littman, because the only way that I could ascertain the figure which would be, in all respects, comparable to the one used in this study would be to bring these calculations down to the present day and see whether or not the percentages are the same or somewhat different.

So far as I know, no major change in the money market has taken place to cause any such change.

Mr. Littman: May I have the last answer read?

(Whereupon, the last answer was read by the reporter.)

By Mr. Littman:

Q. Now, Mr. Coffman, you would not consider it unfair to apply the 12-percent rate to the total of common stock and earned surplus shown in the Securities and Exchange Commission's statement on Page 17 of its opinion in the amount of \$26,507,216 for the purpose of determining the earnings requirements for such common stock and earned surplus?

A. No, sir, I would not under the statements that have just been made.

Q. And to state it another way, you would consider it quite fair to do so?

[fol. 7548] A. I would say that it was fair to do so until and when such analysis as I have already made to determine a 12-percent basis should indicate a change in the money markets which would indicate that something other than 12 percent should be used.

Q. And you know of no such change at this time?

A. I know of no such change in the money market that has occurred to date that would cause it, although I have not made the new calculations as of today.

Q. Now, you speak of making new calculations. What do those comprise?

A. Well, as you know in this testimony and in Exhibits 63, 64 and 65, I have attempted to determine the investor's appraisal of the risks of capital by considering earnings on the one hand and prices of the various classes of securities of different companies as of August 31.

That was the date when my study came to a close. Now, were I to make a study today, I would bring those prices and earnings down as close to the date as the most recent figure would be available, go through the same procedure, calculate my ratios and so on and from those additional figures attempt to determine whether or not the judgment figure of 12 percent still seemed the reasonable one.

Q. In other words, you would use the same method that you used in your study contained in Exhibit 65 to arrive [fol. 7549] at the 12 percent shown in Exhibit 65?

A. Well, yes, or to broaden it a bit, in Exhibits 63, 64 and 65.

Q. You considered Exhibits 63 and 64 as well as Exhibit 65?

A. Yes, that is correct. I considered all three of them.

Q. Now, will you please apply the 12-percent rate for the earnings on the common stock and earned surplus to the \$26,507,216 shown on the Securities and Exchange Commission's statement on Page 17 of its opinion, which is Exhibit No. 147. A. Yes, and that amount is \$3,180,866.

Q. Now, will you kindly add the total earnings requirements which we have calculated and discussed heretofore which give effect to the changed conditions after the re-

financing of the bonds, preferred stock, common stock and surplus of Panhandle Eastern?

A: That total is \$5,018,397.

Q. I want to be sure I have that figure. A. \$5,018,397.

Q. In your opinion and to the best of your knowledge, would this amount of \$5,018,397 represent a fair return to Panhandle Eastern Pipe Line Company on the pro forma amount of \$75,771,472 of invested capital shown in the [fol. 7550] Securities and Exchange Commission's consolidated statement on Page 17 of its opinion?

A. Well, if you will pardon me again, I would say that the \$5,018,397, without talking about fair return, is the amount the company would have to have to attract investors into this business under the pro forma set-up as shown in Exhibit 147.

Q. And is that amount of \$5,018,397 comparable to the amount of \$5,064,821 shown in your Chart No. 37 and there labeled "Current capital requirements" and "A fair return to investors"?

A. That is comparable with the figure you mentioned.

Q. Now, will you please state what the earnings requirement of \$5,018,397 is when expressed in percent of the total invested capital indicated on the pro forma side of the Security and Exchange Commission's consolidated statement?

A. Well, if the machine is correct—and I have some doubt about it—it is 6.62 percent.

Q. Will you please state what figures you used so that we may check the machine?

A. I used \$5,018,397 as the total required for the securities under the pro forma statement contained in Exhibit 147, and divided that by the total capital of \$75,771,472.

Q. The 6.62 percent figure gives effect to the change in conditions which we have heretofore discussed in connection with the company's capitalization and refinancing, does it not? A. That is correct.

[fol. 7551] Redirect Examination

By Mr. Wheat:

Q. Mr. Coffman, I think, if I recall correctly, that Mr. Littman referred you, in his cross-examination at the outset, to your Chart No. 37 in Exhibit 65. Is that correct?

A. Yes, that is correct.

Q. As a matter of fact, he has referred you to that chart a good many times during the cross-examination, has he not? A. Yes, sir.

Q. I wish you would state briefly just what Chart 37 purports to show.

A. Chart No. 37 in Exhibit 65 purports to show, on the [fol. 7552] basis of the capital structure at the time this analysis was made, what, in my opinion, the company would have to have by way of dollars annually, that is, dollars of gross revenue annually, to enable it to pay for its operations and maintenance, taxes, allow for a return on capital when gas reserves are exhausted, and an amount in addition which would maintain the credit of this company on a basis so that the company could secure new capital when and if needed. It is presented in this fashion because I had in mind that one method of approach to this problem of rate of return was to consider specifically the dollars that a management would need, year in and year out, under whatever conditions were existent, and I took the conditions at the date of this study to use as the basis of my thought that the management would have to have to allow for all the things I have mentioned which, if you convert to different language, would be to enable this company to render its service properly to the public and maintain its credit position.

Q. I notice you state on Chart 37 that what you have had to say there in that chart is based on present capital structure. Do you note those words in that chart?

A. Yes, I do.

Q. I wish you would state why you used that expression, "based on present capital structure".

A. Well, at the time I made the study, the capital [fol. 7553] structure of the company included notes, bonds, preferred stock, and common stock, and although there was a possibility that some change might take place in the capital structure, I did not know at the time of the study what the change might be, specifically, and in order that the Commission could understand my approach and tie it up with figures that were available, I made the calculation on the capital structure then existent.

Q. Now, I believe also you did make an alternative study based on some change in the capital structure. That is correct, isn't it? A. Yes, that is correct.

Q. And does Chart No. 36, Exhibit 65, contain a similar summary of your conclusions based on that particular hypothesis?

A. I have followed the same method in my analysis which is portrayed on Chart 36 of Exhibit 65 as I did and as is shown on Chart No. 37, with the exception that I made the assumption there that the preferred stock which was outstanding at the time I made the study might be refunded on a basis of the preferred stock being paid off by an issue of 50 percent of the amount being in bonds and 50 percent being in common stock.

Q. Now, this has been a rather lengthy cross-examination and I am not sure that you have entirely given your reasons for that particular operation. I wish you would restate for the record what impelled you to make that [fol. 7554] particular study that you have just mentioned.

A. During the course of my examination, I reviewed the capital structure of a number of natural gas pipe line companies, and I found that, excluding the Panhandle Eastern Pipe Line Company, there was only one other pipe line company that had any preferred stock outstanding.

Q. Will you please refer to any part of your Exhibit 65, or your other exhibits where you show the results of that study?

A. I seem to have difficulty finding that one exhibit each time. It is Chart No. 25 in Exhibit 65.

In there, I reviewed the capital structure of the Cities Service Gas Company, El Paso Natural Gas Company, Interstate Natural Gas Company, Memphis Natural Gas Company, Mississippi River Fuel Corporation, Northern Natural Gas Company, Southern Natural Gas Company, and Panhandle Eastern Pipe Line Company, and, as shown in Chart No. 25 of Exhibit 65, of all those companies, as of December 31, 1940, only two had preferred stock outstanding. The El Paso Natural Gas Company, of its total capital, had 6.85 percent represented by preferred stock, and the Panhandle Eastern Pipe Line Company, as of the same date, had 18.52 percent represented. All the other companies had no preferred stock outstanding at all, and I concluded from that analysis that these various natural [fol. 7555] gas pipe line companies had, for one reason or another, not found a preferred stock a most suitable vehicle of financing. I might say that in the case of El

Paso Natural Gas Company, that most of the preferred stock that had been outstanding had been recalled, and that portion represented by 6.85 percent, I believe, was merely those shares remaining outstanding which had not, to the date of this analysis, December 31, 1940, yet been turned in; but even that company was trying to eliminate its preferred stock.

Because of those reasons, I felt it a justifiable conclusion that preferred stock did not prove to be, in this industry, the most suitable means of refinancing or financing.

Q. Now, Mr. Coffman, I note in consulting Charts 36 and 37, that the total figure shown in the column at the left-hand side differs, to some extent, to the one on Chart 36, being \$15,459,545, and the one on Chart 37 being \$15,520,855.

Now, based on your previous answer, is it proper to say that these two figures represent, respectively, the total revenue which, in your opinion, would be required, based on your study; first, if the preferred stock were to be refinanced as you have just mentioned, and, second, if the present capital structure were to remain?

A. Yes, that is correct. Those two figures represent, [fol. 7556] in my opinion, the amount of dollars annually of gross revenue that the company would have to have to make allowance and cover the various expenditures which I have enumerated and maintain the capital requirements of the company, which, in turn, would enable the company to render its services properly to the public.

Q. Now, I think you have outlined it, but I would like to have you again restate your reasoning in reaching that conclusion.

A. Well, on each of the items under the caption of "Operations and Maintenance" on both Charts Nos. 36 and 37, Exhibit 65, I have a supplemental chart which shows how I arrived at those figures. On "Operations and Maintenance," for example, on both Charts 36 and 37, the amount which I have used in my calculations, to cover such items, was \$3,516,000, and that figure is explained on Chart No. 29 of Exhibit 65, wherein I indicate that I took the most recent figures that were available to me at the time I made the study, that is, the actual operating results

for the 12 months ended June 30, 1941, which was an amount of \$3,196,797, and that figure was made up of two items: operations, \$2,902,353; and maintenance, \$294,444; and, after an analysis of facts and data which I am following currently in line with my work with Standard and Poor's Corporation, which take into consideration the general trend of various important economic factors that have a bearing upon different operations, I thought it was reasonable to make an allowance for a 10 percent increase in such figure.

Applying the 10 percent to the over-all figure of \$3,196,797 which was—

Q. (Interposing) When you say that you thought it was reasonable, do you also deem it conservative under the conditions which we now face in this country?

A. Yes, I feel it is conservative because, under the national emergency, I believe that until the war ends or the emergency is over this country is going to devote its entire attention to the war, and if that is true, there will be adjustments of all kinds in industrial operations, so that there will be shortages of material in numerous instances for non-defense work, as such.

There will also be demands on the part of labor for additional wages because of the times and the fact that their own living costs are going up, so that I felt that 10 percent was a very conservative figure and was reasonable, and applying that to the actual figure for the 12 months ended June 30, 1941, gave me what I term a projected amount of \$3,516,000 for that particular division of the operations of this company.

Q. Did you have in mind an increase of exactly 10 percent in each individual item that goes to make up that total? [Tol. 7558] A. No, as I think I have testified already, I did not have before me the breakdown of these various items and, therefore, did not consider each one individually.

What I did, because of knowledge of the general trends in the country and having merely a figure which was presented to me in the interim report of the company covering the actual 12 months period ended June 30, 1941, I applied an over-all percent of 10 percent to the figure.

Now, getting down to individual items, had I had those items before me and considered each one, some might have been higher than 10 percent, some might have been lower than 10 percent, but the over-all average, I think, would be reasonably and conservatively stated at 10 percent?

Q. Now, you have discussed previously this matter of operations and maintenance. That, in general, as you have stated, is what you did in order to get those figures, is it?

A. For that one item, which projected figure I used in both Charts Nos. 36 and 37 in Exhibit 65.

Q. Now, is it necessary for a company of the nature of Panhandle Eastern to earn a sufficient amount through the sales of its product to cover the cost of its operations and maintenance?

A. Yes, it is. Each day that goes by requires some operations in regard to this general classification, so that there are wages and other items of expense in that accounting classification which have to be met, so that you have a [fol. 7559] company which is paying out cash, day by day, as it goes along, and it cannot continue to do that unless it has income sufficient in cash to meet such payments. In other words, that is merely the operation of a going concern where you receive money in and pay money out and, therefore, if it is to be successful and the service is to be satisfactory to the customers, sufficient income will have to be forthcoming to meet the various items of expense.

Q. All right.

Now, turn to your item of taxes. Quite a little discussion was had with respect to that item on cross-examination. I wish you would, in your own words, outline just what you did with respect to that item so we will have it all in one place.

A. In Charts Nos. 36 and 37 in Exhibit 65, I show an amount for taxes of \$4,399,000, and the method whereby I arrived at such figure is shown in Chart No. 30 of Exhibit 65. Generally speaking, I followed the same procedure in regard to this item that followed in regard to the figure for operations and maintenance. In other words, I examined the figures for the 12 months period ended June 30, 1941,

[fol. 7560] which were the most recent and last available, so far as actual operations were concerned; and the total taxes amounted to \$3,008,117, which total was comprised of two general classifications: \$649,017 for State, local, and miscellaneous Federal taxes; and \$2,359,100 for Federal income and excess profits taxes. Here again, having in mind the economic trends that were existing at the time of this study, I allowed for a 10 percent increase as a reasonable expectation for such items.

Q. Were those trends existent only at the time you made those studies or are they still existent?

A. No, they are still existent, and the same thing applies, as I have said before, so long as the war continues and the Government has to devote more and more of the various manufacturing and other equipment we have in this country to war purposes, and also has a larger amount of expenditures for war purposes, such moneys will have to be forthcoming from increased taxes and presumably from further Government financing, so that these conditions will continue in that general trend, I should presume, until the emergency is over, and it may continue, so far as taxes are concerned, after the emergency is over, if we expect sometime in the future to begin to reduce the public debt, which will be the largest we have ever faced in this country's history. It already is, as a matter of fact.

[fol. 7561] Q. Have you, in the course of your studies, discovered any indication that tax rates are going to be lower, at least during the present emergency?

A. No, they cannot possibly be lower. They will have to be considerably higher in order that the Government may have an opportunity to secure as much money as possible from taxes to help pay this defense bill, and that portion that the Government does not get from taxes will have to be forthcoming by increasing the Government debt. It will have to come from borrowings from the public.

Q. Would it be your view that the 10 percent allowance which you have made for any further increase in Federal taxes is too great a figure, based on your present knowledge since you made this study?

A. No, I think that the trend will continue in the general direction on the upward side; and, in support of the analysis that I showed in Chart No. 30 of Exhibit 65, I, at some request that was made, also prepared a supple-

mentary exhibit which is listed or recorded as Exhibit No. 152, to show just what the influence was of the increases that are taking place and, so far as I can see, will very definitely continue.

Q. Now, in that connection, Mr. Coffman, I do not believe that Exhibit No. 152 has been thoroughly explained [fol. 7562] in this record and I should like to have you state what is contained in that exhibit and explain it in some detail.

A. I attempted in this exhibit to supply data which had not been set forth fully in Exhibit 65 in regard to the tax figure, and Exhibit 152 contains four pages, three of which are calculations based upon the figures available and the trend of tax rates, and the last page, which has also been referred to, contains a statement by Mr. Morgenthau in regard to what might happen if this emergency continues and the cost thereof is greater than any of us now foresee.

On page 1 of Exhibit 152, I show under the caption "Estimate of Federal income and excess profits taxes," applying rates levied in the Revenue Act of 1941 to the net income for the year ended June 30, 1941, and the reason I did that is because the full year 1941 had not expired at the time I made the study.

Q. You did not, in other words, at the time you made the study, have available the revenues and expenses and, therefore, the net income for the entire year 1941, did you?

A. No, I did not, and as the annual report of the company shows, the full year 1940 taxes would have been calculated at the rates specified by the Revenue Acts of 1940, and there were two such acts, known as the First Revenue Act and the Second Revenue Act of 1940.

What I attempted to do here was to reconstruct the [fol. 7563] situation, showing what the tax would be if the taxable income were the same figure as shown for the 12 months ended June 30, 1941.

Q. I believe you stated also, did you not, that you made this study largely in response to a suggestion or request of the presiding Examiner? A. Yes, I did.

Q. Now, would you proceed to explain this exhibit? I believe it was also a request by Mr. Littman, was it not?

A. I think it was. I am not sure but I know that it was requested during the course of my cross-examination.

Q. Yes. Now, will you proceed with your discussion of Exhibit No. 152 in some detail, Mr. Coffman?

A. Exhibit No. 152 shows that the Federal income tax at the 1940 rate of 24 percent would have given a taxable income of \$6,675,800, and the Federal excess profits tax of \$756,900 indicates, at 1940 rates, excess profits, of \$1,605,800.

Q. When you say "excess profits," you mean that term, do you, as it is defined in the so-called Excess Profits Tax statute?

A. Yes. That, I believe, was called the Second Revenue Act of 1940, which was the Act which was to provide for a tax on excess profits as against our earlier revenue acts, [fol. 7564] Q. Yes. Now, will you proceed?

A. And applying the rates there, there would have been a tax of \$204,000 on profits of \$500,000, and there would have been a tax of \$552,900, which represented a tax of 50 percent, indicating a total excess profit of \$1,195,800 which was subject to that particular tax rate.

Q. That is the same figure, is it not, as the \$1,605,800 minus the \$500,000 item covered by your \$204,000 tax?

A. That is correct.

Q. What total tax was shown?

A. The total tax for excess profits was \$756,900.

Q. Yes. A. Now, coming down—

Q. (Interposing) Pardon me; what you have been saying is that the figures you have just been quoting are on the 1940 tax rate, is that true? A. That is correct.

Q. All right. Now, come to the year 1941 and state what you did with respect to that?

A. Well, I used the same figures but applied the Revenue Act of 1941 which contained increases in rates. The excess profits indicated by the tax reported for the year ended June 30, 1941, was \$1,605,800. I added that to the normal tax which was not deductible under the 1941 Act of [fol. 7565] \$1,602,200. The amount subject to the excess profits tax, therefore, was \$3,208,000.

Q. Under the Revenue Act of 1941?

A. That is correct. So that taking off the tax first on the non-excess portion of \$500,000, and then considering the new excess profits tax bracket in which this company

would now fall under the new Act, which was the 60 percent bracket, there would have been a tax of 60 percent on the differences between \$3,208,000 and \$500,000, or an amount of \$2,708,000. Those were the base figures. So, if I took the amounts then to be taxed to make the overall computation for both the 60 percent and the amount taken out prior to the application of that portion of the Act, the total would have been \$1,878,000.

Now, the taxable income indicated by the tax reported for the year ended June 30, 1941, was the figure that I have been using, namely, \$6,675,800, and I deducted therefrom the excess profits tax of \$1,878,800, leaving an amount subject to the normal and surtax rates of \$4,797,000. The normal tax rate at the time was 24 percent, which gave me \$1,151,280.

The surtax was 6 percent on the first \$25,000, or was \$1,500, and the remaining amount that was subject to surtax was \$4,772,000, to which a rate of 7 percent was applied, giving a tax thereon of \$334,040, so that the total normal and surtax amounted to \$335,540.

[fol. 7566]. Q. That is the total surtax, is it not?

A. That is the total of the surtax.

Q. Yes, not the normal and surtax?

A. No; the total of the normal and the surtax is \$1,486,820.

Q. Yes.

A. So you add that figure to the excess profits tax of \$1,878,000 and get a total of \$3,363,000.

Q. Now, Mr. Coffman, will you glance at Chart No. 30 of Exhibit 65 and tell us if the item of \$3,363,000 noted at the right of the column labeled "Projected" is a figure based upon calculations of some similar character to those shown in Exhibit 152?

A. In Chart No. 30 of Exhibit 65, the \$3,363,000 which I have mentioned, which records the effect of the rates contained in the 1941 Act, is shown as a separate item.

Q. In the right-hand bar?

A. In the projected bar; and in addition to that, I show \$700,000 to cover State, local, and miscellaneous Federal taxes, and also an item of \$336,000 which covers the 40 percent increase in Federal taxes, as such.

Q. Which you have mentioned just previously in your testimony?

A. That is correct, and the total of the three items just mentioned gave me the \$4,399,000 which I used as the [fol. 7567] projected tax figure.

[fol. 7570] PAUL B. COFFMAN, a witness, having been previously duly sworn, resumed the stand and testified further as follows:

Redirect Examination (Continued).

By Mr. Wheat:

Q. Mr. Coffman, I think at the close of last evening that you had completed your discussion of Page 1 of Exhibit 452 which deals with the matter of Federal income and excess profits taxes. Is that a fact, had you completed your discussion of Page 1 of that exhibit?

A. Yes, sir, I had.

Q. I wish you would turn to Page 2 of that exhibit.

Mr. Wheat: These pages are not numbered, Mr. Examiner, but I am referring to the second page of the exhibit as clipped together.

By Mr. Wheat:

Q. The heading of that page is, "Summary of increases in Federal taxes on incomes for the years 1936 to 1941, both inclusive."

I would like to have you outline what you have included [fol. 7571] under that heading, Mr. Coffman.

A. Well, I have attempted to present additional data in regard to the over-all tax situation which would show why, in my opinion, I thought that the increase in taxes which I had projected for purposes of my analysis as shown in Exhibit 65 over and above the actual taxes reported by the company for the 12 months ended June 30, 1941, was a reasonable increase.

In this Page 2 of Exhibit 452, I make a comparison for the calendar years 1936 to 1940, both inclusive, of the

actual taxes, both normal and excess profits and the total, to see what the general trend was so far as the over-all tax payment was concerned.

In 1936, the company paid \$230,000 of normal taxes. There were neither surtax nor excess profits tax at that time.

Q. Well that was before the company obtained the Detroit load, was it not?

A. Yes, that is correct. That change came in 1937.

Q. And simply reflects, does it not, in general, the lower scale of earnings at that time? A. That is correct.

Q. I was going to ask you whether, in general, there has been an increase in each year since then?

A. Yes, there has been an increase in each year. I [fol. 7572] do not know as it is necessary for me—

Q. (Interposing) Yes, I think you should explain this in detail, Mr. Coffman.

A. Continuing with the specific figures then, in 1937, the normal tax was \$492,000 which was the total tax for that year and figuring the increase of \$492,000 over the \$230,000 paid in the previous year represented an annual increase of 13.9 percent.

Q. And that also, was without any surtax, was it?

A. Yes, that was also without any surtax.

Q. Would you say that that increase reflected increased net earnings on the part of this company?

A. For the most part, it did.

Q. Now, what happened in 1938?

A. In 1938, the normal tax was \$513,426 which was the total tax, there being neither surtax nor excess profits and that increase represented 4.4 percent over 1937 taxes.

Q. A much smaller annual increase than the year before?

A. A much [small] increase, that is right.

Q. Then you began to hit real increases, didn't you?

A. In 1939, there begins to be a step-up.

Q. What happened then?

A. The normal tax was \$820,286 in 1939. There was no surtax or excess profits tax but that increase represented [fol. 7573] 59.8 percent over the 1938 level.

Well, before I go on, I merely wish to point out that up to 1940, it has been a consideration of normal tax only and there was not any major change in the rates in that period, so that those percent increases, to a large extent, could be attributable to increased earnings which were subject to the tax but, in 1940, when the excess profits tax Act, known as the Second Revenue Act of 1940, was passed, the company has a step-up in normal tax and also an excess profits tax.

The normal tax in 1940 was \$1,436,598.

Q. An increase of slightly over \$600,000, is that true?

A. That is correct.

Q. In the normal tax? A. In the normal tax.

Q. In addition, did the company then, for the first time, have an excess profits tax?

A. Yes, and there was a change in the normal tax rate so that it wasn't all because of increased earnings but a change in rate and the excess profits tax was a new tax [fol. 7574] which had come through the second revenue act. That amounted to \$561,000, making the total tax bill to the company \$1,997,598, or the equivalent of the 143.5 percent increase in over-all tax load in comparison with the 1939 total tax paid.

Q. As a matter of fact, that was over \$1,100,000, was it not, the increase?

A. Yes, that is correct.

Q. Now, that is 1940. What happened with respect to the tax situation after December 30, 1940?

A. The company in its report covering the twelve months ending June 30, 1941, showed normal tax of \$1,602,200 and excess profits tax of \$756,900, or a total tax of \$2,359,100 representing an 18.1 percent increase over the tax shown for the calendar year 1940. However, the company in computing this tax based it entirely upon the rates levied under the Second Revenue Act of 1940 and also made no provision for special non-recurring tax allowances that arose by reason of the refinancing in February, 1941.

Q. In other words, as of the end of the first six months of 1941, you already had 18.1 percent increase in Federal taxes based on the 1940 tax rates? A. That is right.

Q. Now, you also projected these figures for the year 1940-1941, that is, from July 1, 1940, to June 30, 1941, [fol. 7575] inclusive, on the 1941 tax rate, did you not?

A. That is correct.

Q. As you have formerly testified? A. Yes, sir.

Q. And what were the figures that you found when you did that?

A. Well, the normal tax and surtax amounted, on that basis, to \$1,485,000 and the excess profits tax at the new rates stipulated in the 1941 Act totaled \$1,878,000 or a total of \$3,363,000, which is the figure that I have testified to and is included in my study, Exhibit 65.

Q. Now, when you speak of that, you speak of the item of \$3,363,000 which appears on Chart No. 30 of Exhibit No. 65 in the right-hand bar, do you not?

A. That is correct.

Q. Now, I think you testified yesterday that that was increased by 10 percent, is that true?

A. That is correct.

Q. And that is the source of the figure of \$4,399,000 appearing as the total of the right hand bar in Chart No. 30, Exhibit No. 65, and the same figure appearing in the bar covering taxes on Chart 36 and Chart 37 of that exhibit, is that correct? A. Yes, that is correct.

Q. Now, I note you have two figures for annual increase on the second page of Exhibit No. 152. I wish you would explain just what those are and how you arrived at them?

A. Those are explained in the footnote shown on that page. The 68.4 is based on an increase over total reported for the calendar year 1940 and the 42.6 percent is the increase over total reported for the year ended June 30, 1941.

In other words, having an interim report as of June as against a full year, I have looked at it both ways.

Q. As a matter of fact, the projected figure of \$4,399,000 would represent a very much larger percentage increase, would it not?

A. Well, the only point about the \$4,399,000 is that it includes another figure beside income and excess profits tax figures so that you cannot make a direct comparison.

Q. Yes. The figure you refer to is State, local and miscellaneous Federal taxes shown on Chart No. 30 of Exhibit No. 65 at the bottom of the right-hand bar in the amount of \$700,000, is that correct?

A. Yes, that is correct and that is not a part of any calculations in this present Exhibit 152. I just want to be sure that is understood.

Q. What I wish to bring out is this, and I will ask [fol. 7577] you this question:

In any of the data contained on Page 2 of Exhibit No. 152, do you reflect the tax increases which may have been suffered by this company in the way of State, local and miscellaneous Federal taxes over and above or separate from the Federal income and excess profits taxes?

A. No, I do not show that on Page 2 of this exhibit.

[fol. 7585] Q. And is Panhandle Eastern a growing company? A. Yes, very definitely.

Q. You understand, do you not, that it has been testified in this proceeding that it will require additional financing from time to time over the next few years?

A. Yes, I believe that that is true.

Q. Does that fact have any bearing upon the necessity for earning the cost of operation each year in the investor's appraisal of the situation?

A. It very definitely does because in any company [fol. 7586] that is growing and in a growing industry, there is a period usually in the early stages, where they may be a waiting period, so far as investors are concerned, speaking now in terms of an actual return that they get on their investment, in other words, dividends received and that is true in Panhandle Eastern.

There is a chart here in this exhibit which shows what the experience had been or was, at least, during the period 1934 through 1940, both inclusive.

Chart No. 12 in Exhibit 65 shows that, in so far as common stockholders were concerned during this early stage of the company's life, when it was just really beginning to get into large-scale operations, no dividends were paid in 1934, 1935 or 1936.

The dividend paid in 1937 was small—

Q. (Interposing) Well, it was about one-third of one percent, wasn't it?

A. That is correct. Then, in 1938, when the company had consummated its Detroit—

Q. (Interposing) I am sorry, I misled you on that. It was about one-third of a dollar. A. Yes, that is correct.

After it consummated its Detroit arrangement whereby it got into a much larger scale of operations, the dividends were then stepped-up, but to me this experience [fol. 7587] represents the usual expectancy in a comparatively new company and a growing industry where the company is growing itself.

Investors, if they think the prospects for the company's success are good, are perfectly willing to invest money in it and wait for a period before they receive dividends so long as the success seems to be in the offing, but whenever the company arrives at a point where it is not necessary to reinvest all their earnings to finance the additional expenditures that are necessary for additional plant and so forth, they naturally expect to come into dividend payments, because that is the only way they can get their money back.

If, in other words, all the earnings, no matter how great, continue to be reinvested in the business and they continue to hold their stock, although the book value continues to go up, the fact is they receive no return of capital or any return thereon.

The only way they can possibly get that is either by a dividend from year to year or at irregular intervals or by a liquidation dividend.

Q. Now, in a growing company, a liquidation dividend would be an anomaly, wouldn't it?

A. In a growing company?

Q. Yes.

A. I do not ever remember having seen one. The only [fol. 7588] current practice in liquidating dividends, aside from an actual liquidating company, would be in cases like

the sulphur companies whereby they pay an annual dividend but break it into parts; one they say is in the nature of a return of capital and the other is in the nature of income, and the reason that that is done is because the sulphur is like the natural-gas business, it is a wasting asset and they have tried, in the sulphur business, to make estimates as to the length of life of a reserve and then they proceed to return the capital each year as they go, breaking it down into the two parts mentioned.

Q. In other words, instead of investing the reserve in additional property, as has been so commonly done in public utilities in this country, there is an actual liquidation on account of the wasting asset?

A. There is an actual payment on account of the wasting asset and then, if they wish to make any new managerial move in regard to new resources, they would set that up as a separate transaction.

In other words, if they can find more rounds of sulphur, they will make a new arrangement.

Q. We will come to that particular problem later, but is it also true that on Chart No. 23 of Exhibit 35, you have disclosed the apparent need of this company for new capital from time to time?

[fol. 7589] A. (Interposing) I am sorry.

In Chart No. 23, the calculations there very definitely show there will be an annual amount necessary for increases in plant or plant expansions and the annual average over the past 5 years, 1936 through 1940, both inclusive, has been about \$4,500,000, so if the company should continue to grow in about the same rate that it did in these years, the presumption is it will need at least that much per annum to continue such operations.

Q. And your studies did not include the amount of capital additions in the year 1941, did they?

A. No, they do not. They were not available.

Q. Now did you take into consideration the amount of capital additions which have been testified in this proceeding as being essential during the next five years?

A. No, sir, I did not have those figures, but coming back to Chart No. 12, if I may, there is one further item

that I would like to comment upon and that is the average figure which I calculated of the percent return to common-stockholders for the period 1934 to 1940, both inclusive:

Because of the period of waiting in the earlier years covered in this chart, the average over the period, even though the amounts have been larger in 1939 and 1940, the [fol. 7590] average only amounted in the entire period to 3.64 percent.

Now, it is my belief that any common-stock investor who has moneys to invest in a company would not wish to invest in a pipe-line or other company with similar risks if he thought that the best he was going to be able to average over the period was 3.64 percent.

In other words, that amount, as I can show from Exhibits 63 and 64, in comparison to investor's risks of capital, is not sufficiently large for the type of risk involved.

Q. Let's turn to Exhibits Nos. 63 and 64 and I wish you would explain what you have in mind.

We will go into some further detail on items which are contained in those exhibits later, Mr. Coffman, but for the moment, explain somewhat at length what you had in mind and what you said and cite the pages of the exhibit.

A. Well, in Exhibit No. 63 on Page 23, which gives a summary figure rather than getting into detail, I show there a 4-year average covering the period 1937 to 1940 for the investor's appraisal of capital risks in various divisions of the utility business and this particular table covers the over-all capital.

In other words, it does not at the moment confine the consideration to common stock alone but on the over-all capital, water companies averaged 5.38 percent.

[fol. 7591] Q. That is a 4-year average?

A. That is for the 4-year average. In other words, what I am trying to show is not a feature peculiar to any one-year because we can see that for a 4-year period which at least can be considered reasonable, the average has been 5.38 percent and the individual yearly figures show no wide variations, so that there is nothing unusual about this period that we are in.

It has been in existence now for at least 4 years.

Electric utility operating companies had 5.47 percent.

Q. (Interposing). These aren't dividends; they are investors' appraisals of capital risks, aren't they?

A. That is correct. These are the earnings-price ratios which are the figures I have been talking about throughout this hearing.

Q. Covering over-all capital?

A. Covering over-all capital, yes, that is correct.

Mr. Littman: Are these figures comparable to the dividend figures of Panhandle Eastern which you just read a few minutes ago?

The Witness: No. I just said these are not. I will come to that later. These particular figures are not.

Manufactured and mixed gas companies, 6.61 percent;

All natural-gas companies, 7.78 percent;

Natural-gas pipe-line companies, 9.38 percent; and

[fol. 7592] Panhandle Eastern Pipe Line Company, for the years in which data on prices were available to make the calculation, which cover 1939 and 1940, 9.15 percent, so that the average of 9.15 percent is a 2-year average, not a 4-year average.

By Mr. Wheat:

Q. Now, the details of the figures making up these averages that you have just read are shown opposite that chart and on Page 23 of Exhibit 63, are they not?

A. The chart opposite Page 23 in Exhibit 63 merely shows graphically what I have read from the statistics. The details actually are supplied in the appendices contained in the end of Exhibit 63. I did not refer to those.

Q. The individual figures from which these averages are calculated are shown on Page 23, are they not?

A. Yes, that is correct.

Q. Now, I know, by looking at that chart, that there seems to be a crescendo or an ascending percentage of investor's appraisal of capital risks. Did you find that to be continued during the year 1941 with respect to natural-gas pipe-line companies and Panhandle Eastern over these

other types of public utilities that you have listed on those pages?

A. Well, there were some changes in the interim period January-August, 1941.

[fol. 7593] Q. But the relative relationships remain the same, do they not, and show a crescendo?

A. That is right. The relationship of one classification of company to the other remains about the same but even for the most part where there were changes in the figures for the interim period January-August, 1941, as compared with the four-year average, 1937-1940, both inclusive, the changes were not marked.

In other words, there had been nothing that had happened, so far as I can see, in that period, that interim period, which had changed either relationship from one class to the other of the investor's appraisal of the particular risk classification and, to make my point clear, water companies, for example, had a four-year average of 5.38.

Q. Percent?

A. 5.38 percent; and for the interim period had an average of 5.24 percent. Well, there obviously is some change there but it is still in about the same neighborhood.

The electric utility operating companies showed a four-year average of 5.47 percent and, for the interim period, 5.61 percent. There again, there was some fractional change but, so far as the relationship of investor's appraisal of the risk on electric utility operating companies, to water companies, the same risk seemed to exist as the [fol. 7594] investors appraised these two situations.

Q. You mean the same general appraisal of risk?

A. Yes.

Q. One against the other?

A. Yes, that is correct, but the reference which I made to the fact as stated at Page 23 of Exhibit 63 when I was talking about Chart No. 12 in Exhibit 65, was to indicate that investors do classify risks very definitely, and that natural-gas pipe-line companies have a higher risk factor in the minds of investors than do other branches of the utility industry.

Q. Would it be fair to say that natural gas pipe-line companies show a reflection of investor appraisal risks greater than these other types of companies in each year of the four full years' study and also in the interim period January-August, 1941?

A. Yes, it would be and further, by making a direct comparison, so far as the figures show, the investor is saying, for all practical purposes, that the risk is sufficiently greater in a natural gas pipe-line company over a water company, let us say, that he must have approximately 4 percent additional to compensate for that additional risk or he is not going to invest his money.

Q. That is, over-all?

A. Over-all, but coming from the over-all picture which [fol. 7595] I have discussed to Chart No. 12 where we are talking about the return, the percent return to common stockholders only, I am just making the point that if the over-all capital appraisal by investors is somewhere in the neighborhood of 9 percent, as shown on Page 23 of Exhibit 63, so far as earnings are concerned, if they require over-all that percent, then when you get down to common stock which is the most risky of any portion of the capital structure, a 3.64 percent return for dividends would seem to be unusually low and I do not believe any investor would be willing, over a period of time, to invest his money in such risks unless he felt that, as the company arrived at an earnings position, a larger dividend would be paid which would give him a better percent return on his equity.

Q. Now, for the moment we got a little off the subject of taxes and before we get entirely off of that, there is one point I would like to clear up.

I think you testified on cross-examination that the current capital requirements based on the financing of preferred stock of Panhandle Eastern Pipe Line Company, which you have shown on Chart 36 of Exhibit 65, was a total of \$4,993,511.

A. Yes, sir.

Q. That is based on your hypothetical refinancing of the present preferred stock of 550 percent of its amount [fol. 7596] in bonds and 50 percent in common stock, is it not? A. Yes, that is correct.

Q. Now, I believe that on cross-examination you testified that that amount of \$4,993,511, representing your estimate of current capital requirements under that hypothesis, was some \$720,000 lower—the exact figure I have here which I believe is correct is \$720,707 lower than the actual net operating income that the company reported for 1940 which, I believe, was \$5,714,218. Is that correct?

A. Well, I made that calculation, I think, once for Mr. Littman, and that sounds correct. I do not have it here any more.

Q. I think I have the exact figures. In other words, that item of \$4,993,000-odd was some \$720,000 lower than net income shown for 1940? A. Yes, that is correct.

Q. Now, at my request, have you made a calculation to show what the net operating income would have been for 1940 had the 1941 Revenue Act been in effect?

A. I have made such calculation and I think that a good portion of the figure was absorbed and I think the actual amount was in the neighborhood of \$600,000.

Q. In other words, you assumed that all other factors were unchanged but that the company had been liable for taxes under the Revenue Act of 1941 rather than under [fol. 75:7] those established in the Revenue Act of 1940?

A. I believe the figure of increase for taxes would have been \$613,358.

Q. And what would have been the net income, operating income after taxes?

A. The net income then would have been \$5,100,860.

Q. On the basis of those figures, would it appear to you that if the net operating income for 1940 could, under any approach, be deemed excessive, the Treasury Department of the United States Government has already taken steps to correct any such situation?

A. Well, yes, very definitely. It has to the extent that the increase in taxes has absorbed already most of the \$720,707.

Q. And there is no sign of any letting up in these increases in taxes?

A. Certainly not in any near term future.

By Mr. Wheat:

Q. Is it your point of view that so long as any moneys, however obtained, are used in the business rather than distributed in dividends or used to pay off debt capital, they remain as invested capital, and the investors expects a return. Would that be a fair statement?

A. Yes, that would be a fair statement, but I might, just to be sure that I am not misunderstood on that fact, add ~~one~~ further fact, that I say that the moneys coming into the business that are retained in the business are considered invested capital from the standpoint of the investors.

Now, so far as moneys not retained in the business are concerned, it must come about, it seems to me, by either a payment of a dividend, a return of capital or pay off capital or, obviously, it can come through suffering a loss. In other words, I merely add the loss factor to be sure I am not misunderstood; because if the company loses money in [fol. 7724] any one year, naturally that loss is carried to surplus and reduces the invested capital by that amount.

Otherwise, I say that all the moneys retained in the business which are remaining there are considered as invested capital from the standpoint of the investor.

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[fol. 7729] Q. Now, turning again for a moment to your Chart No. 37 in Exhibit No. 65, and excluding from consideration in this particular question the item of current capital requirement, which is the righthand bar shown on that chart, do you wish it to be understood to be your testimony that the method which you have adopted of reaching the other item of (1) operations and maintenance; (2) taxes; and (3) return of capital when gas reserves are exhausted, are the only methods which can be used in that connection?

A. Now, I am not saying any such thing at all. What I have tried to say here is that the method that I have used to approach this problem is at least one realistic method and seems to me to be a necessary part of the overall study.

There may be any number of other methods. All I contend is that I think this method very definitely has a place

in such study and further than that is realistic in its approach.

Q. Now, looking at the lefthand bar in Chart No. 37, which is a summation of the four other items and is captioned "Total Dollars Needed," let me ask you whether that total amount that you have there shown allows for or contains any estimate of additional volume of business? [fol. 7730] A. No, the lefthand bar as shown in Chart No. 37 of Exhibit 65 does not allow for an increase in business. What I attempted to do here was to show that economic conditions were changed to such an extent that if you took those factors into consideration alone, without the variable of an increase in business, it was changing the operating results, or they were changing the operating results of this company materially that allowance would have to be made in any consideration of this kind for those changes.

Now, whether or not the company increases the business, so far as I can see at the present time, these changes, economic changes are going to continue. In other words, I have cited the case that materials and labor and so forth which have been going up, and I think are going to continue to go up some time in the future.

Q. You are speaking of these sharp rises in the cost of doing business that you have mentioned before, is that correct?

A. That is correct, and the same is true of taxes, that the trend is such at the present time that one can anticipate further increases in tax rates and, therefore, further tax payments on the part of all corporations, as well as individuals.

[fol. 7731] Q. Did you relate these various facts to the latest date on which, at the time you made your study, you could find definite and recognized data?

A. Yes, I used the statement which was available of June 30, 1941, which was the most recent statement published by the company at the time I undertook this study.

Q. Now, as far as these items which lie below the item of current capital requirements are concerned, is it true to say that you would admit that if a detailed study of the company's operations disclosed that these facts were incorrect, you would still wait and stand upon them as such?

A. No, I have not made any such contention as that. What I have said was that I think the approach in and of itself has merit. I did not examine the books, as I have already testified, nor did I have any detailed figures flowing from any of the accounts kept in the company's offices.

What I used, because I was taking the investor's point of view, was statements that are available to him and all of my study, so far as the company is concerned, was based upon the figures contained in the interim report which was dated June 30, 1941.

Now, if a study were made which would indicate that any of the items reported therein were not proper [fol. 7732] and a proper figure were determined, I would substitute that in the approach and see what the new result was.

However, so far as the current capital requirements are concerned, that particular figure is based upon an analysis outside the company's figures altogether. As I think I have pretty clearly explained, it is based upon the method whereby I considered all of the quotations on the various securities relating to this or having relation to this particular business to ascertain what the investors were saying at the time I made the study and to what they required by way of an earnings-price ratio to increase capital in that business.

Q. Well, you understood that my question went to the other items?

A. I recall you did say something on that.

Mr. Littman: In order to clarify one point, Mr. Wheat, may I interrupt?

Isn't it correct that you used the actual figures of the company for the bonds and preferred stock, but you used the earnings-price ratios for the common stock? That is what I understood your testimony to be, and I wanted to call that to your attention, because I did not believe your statement was in accord with that.

The Witness: I am talking here about the equity common stock which is included in the over-all figure captioned, [fol. 7733] "Current Capital Requirement."

Mr. Littman: But my understanding is correct, is it not?

The Witness: Yes.

Mr. Littman: You used the actual earnings requirement paid on the bonds and preferred stock?

The Witness: Yes, that is correct.

By Mr. Wheat:

Q. But I understood you also to say that you used the earnings-price ratios on the common stock or equity items, because you felt that that was the only method by which you could get at the capital requirement for those items, is that correct?

A. Yes, and behind the whole study is the material that I analyzed which I have called the "Investor's Appraisal Of the Risk of Capital," which is presented in Exhibits 63 and 64, which is based upon an over-all capital consideration. I mean there the earnings-price ratios which are calculated are based upon bonds, preferred stocks, and common or all these securities of the companies listed where such data was available.

Q. Of course, I take it, Mr. Coffman, that in your statement to the effect that if someone brought in a better figure for these operations, maintenance, taxes or return of capital when gas reserves are exhausted then you may [fol. 7734] have been able to get—provided such thing would happen—I believe you have already stated that these fundamental economic trends of labor, material, and taxes would also have to be given consideration, isn't that true?

A. Yes, that is correct. So far as the economic conditions are concerned, which I have appraised to the best of my ability, and so far as trend is concerned at the date of this study, that would stand. In other words, if I made an over-all allowance of ten per cent for an increase in an item because I thought there was at least that much change due to changing conditions, I would still use that figure, but if the base figure to which it was applied should change, after a thorough study which would indicate that the figure I used and which is in the 1941 statement was wrong, I would be willing to use it, of course.

Q. In other words, I take it you went to the best information you knew how to get from the standpoint of the investors, is that correct?

A. That is correct. I went, as a matter of fact, to the same source that the investor goes to.

Q. And have you any reason to suppose that the amounts that you have included in your study for the item of changing price levels are too high?

A. I have no reason to suppose that. I can cite one [fol. 7735] example in regard to material costs.

As I recall it, the average of wholesale commodity prices, as reported by the United States Bureau of Labor Statistics for about the first eight months of 1941, was around 80 per cent, around 76 per cent, I guess it was, and, at the present time, I think it is around 95 or 96 per cent. As I recall it it is something like 18 or 19 per cent greater as of this time, so that is just one item where there is definite evidence as to what the changing economic conditions are doing at the present time.

Q. Now, you cite that in connection with your ten per cent allowance. Is that true?

A. Yes, I made a ten per cent allowance over-all, and I have already testified that I did not have individual items, but if I had some might have been more than ten, others less than ten, but it seemed to me that ten per cent was a reasonable estimated figure over-all.

Q. Now, this morning you mentioned this map which is Chart No. 1, in Exhibit No. 65. I wish you would turn to the next six charts which appear as Charts 2 to 7, inclusive, and in the light of what you have been testifying, state what the purpose was of including those particular charts and, to your mind, what they show in this connection.

A. I think I have just said a few minutes ago that [fol. 7736] the natural gas industry and the Panhandle Eastern Pipe Line Company were growing enterprises and I thought that had a pertinent bearing upon such an analysis as this and to familiarize myself with the actual conditions over a period of time, I inserted Chart No. 2 in Exhibit 65, which is captioned, "Growth of Natural Gas Industry in the United States," covering the period of 1906-1940, both inclusive.

There are two sets of data shown graphically, one relating to the natural gas production and the other relating

to the domestic and commercial customers, and those data, shown graphically, indicate that over a period of years the natural gas industry has been showing a very marked growth factor, and the growth factor is particularly marked, beginning around 1932 and 1933, and continuing to date, so far as natural gas production was concerned.

The growth in domestic and commercial customers is also marked, but the line is not as sharp from 1931 to 1939, the last available figure at the time I made this study, as was the case in natural gas production. So I concluded from those data that they showed clearly that this industry was a growing industry. It was not a stable industry, nor was it a decadent industry. It is still in a growing trend.

Q. Well, if this concern you are dealing with were on [fol. 7737] a static basis, would you feel that the factors you have used would have to be reexamined?

A. Yes, very definitely they would have to be reexamined because at least one factor presumably would be somewhat changed, namely, that if there was no longer any growth of the company, I would not feel this need for further reinvestment of capital in this business. I would presume that their plant and equipment, and so on was sufficient to take care of the business under that static condition.

Q. When you said "reinvestment of capital," did you include investment of new capital?

A. Reinvestment of capital and investment of new capital.

Q. Did your study, however, shown in these charts, in Exhibit 65, convince you that new capital would be required?

A. Well, I think I referred this morning to Panhandle Eastern Pipe Line Company, indicating that the recent past history showed an average of about \$4,500,000 of additional plant expansion on the average each year, and with the trend what it is in the industry, and the trend what it is at the moment for the company. I should suppose that continued plant expansion might be expected.

[fol. 7744] Q. Mr. Coffman, I would like to have you turn to your Chart No. 11 of Exhibit 65. On the lefthand portion of the chart, I note, and as brought out on cross examination, there is a portion of each column for each year shown as net property after reserves, and then another portion shown as net working capital and intangibles. Has there been any thought on your part in your study of amortizing working capital, as such, in this business?

A. No. That "as such" in your question is not what I was attempting to do. The view that I took on the business was that if, through earnings or otherwise, moneys were received by this company and retained in the business, so long as they were retained in the business they had to be considered as invested capital from the standpoint of the investor.

In a particular calculation which I made from the figures shown in the company's statement as of June 30, [fol. 7745] 1941, there was a figure for working capital including cash, and it was my contention that so long as that money remained in the business, the investor would require a return thereon. If it were not needed in the business, it then could have been used to pay off debt, thereby reducing the invested capital. If that were not done, it was still invested capital, and I believe the investor would require a return on it.

Q. As a matter of fact, it would be reinvested in the business, would it not?

A. So long as they kept it in the business and used the cash or other forms of working capital for other operating purposes, it would very definitely be used in the business.

Q. Now, I notice you have got a heading on the top of the lefthand chart on Chart 11, "Invested Capital," and you have the same heading, "Invested Capital," on the lefthand portion on Chart No. 10. Will you please explain the nature of these two methods of looking at invested capital?

A. I attempted, in chart No. 10 of Exhibit 65, to show invested capital when it is defined as being the net debt, the preferred stock and common stock, and surplus as shown in the balance sheet of the company.

That indicated that the figure for 1940 was \$59,400,000 [fol. 7746] in round figures.

In Chart No. 11 I attempted to show the invested capital when such term is defined as net property and net working capital and intangibles, and on that basis, I found that 1940 figure to amount to \$59,900,000. In other words, regardless of which definition of invested capital when used, it so happened that the figures for this company were approximately the same.

Q. In other words, you found a close correlation, did you, between the two? A. That is correct.

Q. By the way, on Chart No. 11, the basic portion of each column is net property after the reserves for retirement or depreciation, is it not?

A. Yes, that is correct.

Q. Now, I believe that in connection with the item of working capital on your cross examination you were confronted with a hypothetical balance sheet which showed something like this, I believe:

*Property—	\$33,000,000.00
Cash and Government bonds	30,000,000.00

Or a total of \$63,000,000 of invested capital.

Now, I wish you would state whether it is customary for a corporation to carry on its balance sheet for any length of time cash and Government bonds totalling up [fol. 7747] proximately 50 per cent of its invested capital?

A. Well, if you say, "By any length of time, something beyond what would seem to be reasonable," I would say that there was no such practice. You might find at a given time, for example, that a company was accumulating considerable cash because it was about to retire a debt or you might find another situation in which some assets had been converted to cash and a decision had not yet been made as to what disposition of such cash would be or it might be another situation in which the company was contemplating the purchase of a new division of the business in which they had secured the cash to have it ready for the final transaction.

Q. Accumulation of purchase price, in other words?

A. Yes. I think, for example, if on Friday, in relation to this new acquisition that the Panhandle Eastern is contemplating in regard to Michigan Gas Transmission Corporation, they will receive some \$25,000,000 from the sale of these securities we have been discussing, and that amount of cash will go into the bank and be there until such time as the checks are drawn to buy the assets that they are contemplating purchasing. Otherwise, I do not conceive of any company carrying such a high proportion in cash or the equivalent of cash in any going firm.

Q. It is possible, I take it from your answer, how [fol. 7748] ever, for a corporation to be fully justified at times, in having on its books what might, over any great length of time, seem to be excessive working capital?

A. Yes, very definitely.

[fol. 7750] Q. We were discussing, Mr. Coffman, this hypothetical balance sheet with which you were confronted on cross-examination. Is it a fact that so long as the item of cash is on the books, it is invested capital from the investors' viewpoint?

A. So far as the investor is concerned, so long as the Company keeps his money, he considers it invested capital.

Q. Well, is it possible that that fact has something to do with your answer to Mr. Littman's question in respect to that balance sheet, as to whether you would apply the rate of return method which you have mentioned to the entire \$63,000,000?

A. Yes, that is the reason it was, in view of the fact that that is exactly the way I have handled it in this approach which is contained in Exhibit 65. It is my contention that if the Company earns money or secures money by new financing and continues to keep that money, [fol. 7751] for varied purposes, so far as the investor is concerned, he cannot use it for any other purpose and, therefore, he requires a return because if he had kept it and placed it elsewhere, he would have at least have had the possibility of making a return thereon.

Q. That is not a contention. That is a fact?

A. That is a fact, so far as the investor is concerned.

Q. Now, I believe there was some question made of the \$4,600,000 which you found on the books as cash at

the time of your investigation as compared with the study made by Mr. Sperry of the Company with respect to working capital for rate base purposes. What have you to say with respect to that matter?

A. It is my contention that so far as the \$4,000,000 odd was concerned, which was on the books as of June 30, 1941, as contained in the report by the Company as of that date, that the Company still held the money. I presumed that the reason that the cash for working capital was retained in that amount was because the management believed they needed it in the ordinary course of their business, and so long as they retained it, the investor would feel that his money was invested in this business and therefore he should have a return thereon for the use or such use as the company might make of it.

[fol. 7752] If it should prove to be the case that over a period of time such money was not necessary in the business, then I contend that the investor would insist that such money be used to retire debt and thereby reduce the invested capital by that amount. So far as the figure of \$1,500,000 was concerned, which I understand Mr. Sperry had mentioned, I did not know anything about that until informed of it in these hearings, and I do not know the particular purpose that Mr. Sperry had in mind when he talked about it.

I was looking at the thing purely from the investor's point of view and, therefore, concluded, as I have already stated, that so long as the money remained in the business, the investor considered it invested capital.

Q. Well, so long as any investment remains in a business, it is invested capital, is it not?

A. So far as the investor is concerned, I do not think there is any other way it can be considered. If they do not need it, they should use the money to reduce the debt or pay off the securities and thereby in that process reduce the invested capital.

[fol. 7758] Q. Your studies contained in Exhibits 63 and 64, I believe, were generally based on over-all investor-appraisal, including all forms of securities, were they not?

A. The material presented in Exhibits 63 and 64 cover the investor's appraisal on the risks of capital and therein are considered over-all capital and by that I mean the bonds, the preferred stock and common stock and surplus.

Q. During the interim between your direct examination and re-direct, you prepared Exhibit 151; did you not, which related to the earnings-price ratios of common stocks only, in various divisions of the utility business? [fol. 7759] A. Yes, I prepared that exhibit at the time you have mentioned.

Q. And in that particular exhibit, did you have occasion to determine the investor appraisal of this with respect to common stock as distinguished from the over-all?

A. Yes, that was the purpose of the preparation. During the direct examination, I was asked some question, as I remember it, about the investor's appraisal of common stocks in the various classifications contained in Exhibits 63 and 64, namely, water companies, electric utility operating companies, manufactured and mixed gas companies, all natural gas companies, natural gas pipe line companies and Panhandle Eastern Pipe Line Company, and at the time the question was asked I was unable to give a specific answer as to the earnings-price ratios to common stocks definitely because the material I had in Exhibits 63 and 64 was not broken down in that respect so I prepared Exhibit 151 as a special exhibit to give attention to the common stock phase of capital only.

[fol. 7760] Q. Now, turning to Exhibit No. 151, in general what was shown by the studies which you undertook at the Examiner's request during that interim which resulted in Exhibit No. 151?

A. In the first place; so that I will be clear on what I did, I covered the same years in this study as were covered in the material shown in Exhibits 63 and 64, namely, the period 1937 to 1940, both inclusive; calculated the 4-year average for that period, and then brought the information down to date for the interim period covering January-August, 1941, on the same topics that I have listed earlier. The exhibit shows that the earnings-price ratios for common stocks, as distinguished from the earnings-price ratios for over-all capital, were higher.

Q. Now, I wish you would turn to your Exhibit 63 and advise us where the figures are obtained which are to be compared.

A. Well, the summary table of Exhibit 63 is shown on page 23, wherein the table there is in exactly the same [fol. 7761] form as the table on Exhibit 151.

Page 1 of Exhibit No. 151. The figures contained on page 23 of Exhibit 63 represent the investor's appraisal of the risks of capital in the various utility businesses, and there, by "capital" I mean over-all capital, the bonds, preferred stocks, common stock, and surplus.

The figures shown in Exhibit No. 151 represent the earnings-price ratios of the common stocks for these same groups, but the common stock only. The comparison of the figures contained in the column captioned, "Four-Year Average, 1937-1940", in Exhibit 151, indicates that the earnings-price ratios of common stocks are higher in every instance than the earnings-price ratios for the same classifications for over-all capital. In other words, the first point that I noted is that the common stockholders ask for a higher earnings-price ratio than do all of the investors in the business, staking in the various classes of securities they might hold.

Q. You mean that do the total group of investors of all types, is that true? A. Yes, that is true.

Q. All right, proceed.

A. The second point to note is that, so far as relationship of risks are concerned, as classified by investors on the basis of an earnings-price ratio, it indicates that they, [fol. 7762] as common stockholders, appraise the risks in the same order as investors of the over-all capital appraise them. In other words, water companies are the lowest, electric utility operating companies are next, manufactured and mixed gas companies third, all natural gas companies fourth, natural gas pipe line companies fifth.

Q. Now, in what you have said there, you are not referring to particular years, are you, but to your average figure?

A. I am referring to the figures shown in the column captioned "Four-Year Average, 1937-1940" in both Exhibit 151 and Exhibit 63, page 23.

Q. And what is the order of the increase of investor appraisal in respect to common stocks and in respect to all types of capital?

A. It is in the order of water companies. That is going from lowest to highest—

Q. (Interposing) You have just stated that. Now, with respect to water companies, I note on page 23 of Exhibit 63 that the four-year average was 5.38 percent.

A. That is correct.

Q. Now, what was it for common stocks of water companies? A. Well, it was 6.50 percent.

Q. And what were the differences in respect to electric utility operating companies?

[fol. 7763] A. In electric utility operating companies, the investor's appraisal of over-all capital risks for the four-year average was 5.47 percent compared with the ratio for common stocks on a four-year average of 7.24 percent.

In the case of manufactured and [mix] gas companies, the over-all capital appraisal for the four-year average was 6.61 percent, and the four-year average earnings-price ratio of common stocks was 8.85 percent.

The ratio for all natural gas companies on an over-all capital appraisal on a four-year average was 7.78 percent, and on common stocks on a four-year average was 12.08 percent, and natural gas pipe-line companies, on an over-all appraisal, was 9.3 percent on a four-year average.

Q. Nine point three what?

A. 9.38 percent on a four-year average, and 13.52 percent for common stocks on a four-year average.

Mr. Littman: On this new Exhibit No. 151, on the first page, where you show a four-year average for the various companies with respect to their earnings-price ratios of common stocks, are those four-year averages straight mathematical averages or are they weighted averages?

The Witness: It is a straight arithmetical average.

Mr. Littman: Now, in your Exhibit 63, in the chart [fol. 7764] shown opposite page 23 to which reference has

just been made by you, showing the four-year average for the various companies, 1937-1940, are those averages straight mathematical averages or are they weighted averages?

The Witness: Those averages, where I have talked about over-all capital, are weighted averages.

Mr. Littman: That is, in Exhibit 63, they are weighted averages?

The Witness: That is correct.

Mr. Littman: And in Exhibit No. 151, they are straight arithmetical?

The Witness: Straight arithmetic, and that is for the reason I think I gave you in our earlier cross-examination where I explained that it was an easier matter to get an over-all capital appraisal on a weighted average basis than I thought it was on a common stock basis where you had variations in capital structure as between the individual companies shown in the individual exhibits and in the different utility classifications.

[fol. 7768] Q. Now, I draw your attention, Mr. Coffman, to Chart No. 22 of Exhibit 65; wherein, on the left-hand bar, you show estimated current cost of financing common stock, a figure of 12.99 percent as the average of pipe-line companies. Is that 12.99 percent the same 12.99 percent which is to be found in the last column on page 1 of Exhibit 151 for natural gas pipe line companies during the interim period January-August, 1941?

A: I want to call attention that the 12.99 is the identical figure, but the 12.99, as contained in Chart No. 20—

Q. (Interposing) Chart No. 22.

A: Yes, in Chart No. 22—is based upon the earnings-price ratio as presented in Chart 20 of Exhibit 65, whereas, in the Exhibit No. 151, as shown on page 4-A of Exhibit [fol. 7769] 151, the earnings-price ratios shown thereon for natural gas company common stocks for the interim period January-August, 1941, covered some additional companies that were not included in Chart 20 of Exhibit 65.

[fol. 7772]. Mr. Wheat: Mr. Examiner, I should like to offer for identification and as the next exhibit, a copy of the purchase agreement in connection with the refinancing and purchase of property which has been mentioned on this record. This is a printed document.

Owing to the exigencies of time and getting it here from New York, leaving late last night Mr. Watkins was unable to get up a certification. I now represent it, however, to be a true copy of the purchase agreement dated February 2, 1942, addressed to Glore, Forgan & Co., and Kidder, Peabody & Co., as representatives of the respective purchasers signed by Panhandle Eastern Pipe Line Company by Louis F. Sperry, Treasurer, bearing on its 15th page a statement to the effect that the foregoing purchase agreement is hereby confirmed and accepted as of the date first above written, signed by Glore, Forgan & Co., and Kidder, Peabody & Co., acting on behalf of the several purchasers named in Paragraph 13 of the Agreement and including Glore, Forgan & Co., and Kidder, Peabody & Co., among such purchasers.

We ask that this be received as the next exhibit.

.

[fol. 7773] Trial Examiner: The purchase agreement, which has just been identified as Exhibit 160, will be received in evidence without objection.

.

PAUL B. COFFMAN, resumed the stand, having been heretofore duly sworn, and testified further as follows:

Redirect Examination (Resumed).

By Mr. Wheat:

Q. Have you, during the overnight recess, been able to obtain data with respect to the price of Panhandle Eastern's stock on the market in New York?

A. Yes, I have the bid prices here from January 28, through February 3.

Q. I wonder if you will read them into the record?

A. Those prices were: January 28, 37 $\frac{3}{8}$;

January 29, $37\frac{3}{8}$; January 30, 37; January 31, $36\frac{7}{8}$; February 2, $36\frac{1}{2}$; February 3, $36\frac{3}{8}$.

Q. That concludes the data that you were able to get as of this morning? A. Yes.

[fol. 7774] Mr. Littman asked that I might try, in addition, to secure the volume, the figures were not available on these days, and these figures that I have here came from the National Quotations Bureau, which sometimes show the volume on over-the-counter transactions, and sometimes do not.

Q. Well, Mr. Coffman, this stock is not listed on the New York Stock Exchange or the Curb Exchange, is it?

A. No, it is not.

Q. And the transactions in this stock are what is known, technically, as "over-the-counter" transactions?

A. That is correct. Sometimes on over-the-counter transactions you can get volume, and sometimes you cannot.

Mr. Littman: Mr. Wheat, may I ask a question of the witness?

Mr. Wheat: Surely.

Mr. Littman: May I ask whether the witness has the asked prices for these dates?

The Witness: The asked prices were—I had most of the prices, I do not know what I did with the sheet, but I can tell you they ran from $38\frac{3}{8}$ to $37\frac{1}{2}$.

Mr. Littman: Will you please endeavor to locate the exact ask prices and read them into the record?

Mr. Wheat: We will endeavor to obtain those, Mr. Littman.

[fol. 7775] Mr. Littman: I would like, also, to inquire on this thing subject, Mr. Wheat, whether any transactions were actually consummated on the dates that you mentioned, if you know.

The Witness: I do not know whether I can find that out. I could try, but when an over-the-counter transaction, the only way I could get it would be to canvass the brokers.

Mr. Littman: You do not know now whether any of these represent actual consummated transactions?

The Witness: No. As I say, I do not know of any way I could find this on the over-the-counter transactions unless I canvassed the brokers to get it.

Mr. Littman: I would, also, like to inquire whether you know, Mr. Coffman, whether any of these quotations involve common stock of Panhandle Eastern Pipe Line Company, owned by Columbia Oil & Gasoline Corporation; or Missouri-Kansas Pipe Line Company, the two parent companies of Panhandle Eastern.

The Witness: May I have that read?

(Question read.)

Mr. Wheat: I do not know whether you mean just what you said, Mr. Littman. I thought you probably wanted to refer to them as the two major stockholders of Panhandle Eastern, did you not? I do not know that this company [fol. 7776] has been shown anywhere to have two parents.

Mr. Littman: I am referring to the two companies who combined, own something in excess of 92 per cent of the outstanding common stock of Panhandle Eastern.

Mr. Wheat: Yes, I think that is probably the preferable way to put it.

The Witness: The answer to the question is that I do not know, Mr. Littman.

[fol. 7785] Q. Now, when we concluded the hearing yesterday evening, Mr. Coffman, you were in the midst of a discussion of certain data contained, respectively, in Exhibits Nos. 151, 63 and 64, I believe.

I think there was some ambiguity in respect to a statement made concerning Table 4-A in Exhibit 151. Let me ask you whether you have included on that table certain natural gas companies in addition to those used in your study in Exhibit 65.

A. Yes, the items contained on Table 4-A of Exhibit 151 cover all natural-gas companies' common stocks, which is

one classification that I used in Exhibit 63 and 64 and the content of Table 4-A covers the entire natural-gas companies which were included in the study.

Q. You mean covers all the entire group?

A. It contains all that were included in the study on natural-gas companies.

Q. Thank you.

A. The figure referred to in Exhibit 65, Chart No. 22, first column, as "Average of Pipe-Line Companies, 12.99 [fol. 7786] Percent" is the identical figure with that shown on the first page of Exhibit 151, but the way that such figure would be determined from Page 4-A of Exhibit 151 would be to pick out of the natural-gas companies, the five natural-gas pipe-line companies which were the basis of the calculations made for Chart 22, Exhibit 65, and those companies were shown on Chart 20 of Exhibit 65.

Q. Mr. Goffman, as a matter of fact, Table 4-A of Exhibit 151 shows an average of earnings-price ratios for all the natural-gas companies included in that table of 13.97, does it not?

A. No, the figure that I have used excludes the Consolidated Utilities Corporation and that is 13.14 percent which is shown on Page 1.

Q. I was about to come to that. First, will you answer this question: Does the average of all that you have used on that table, first, show 13.97? A. Yes, it does.

Q. And if you exclude the Consolidated Utilities Corporation, for the reasons stated on that page, do you reach the figure 13.14 percent?

A. Yes, and that is the figure shown on Page 1 in the summary of Exhibit 151.

Q. Yes.

Mr. Littman: The figures you just gave relate to common stocks, do they not?

[fol. 7787] The Witness: Yes, they are the earnings-price ratios of common stocks.

By Mr. Wheat:

Q. These are the data which you prepared at the request of the Examiner? A. That is correct.

Q. Well now, these are price ratios for common stocks only, as I understand it, whereas the data contained in

Exhibit 63 and Exhibit 64 include other types of securities, is that correct? A. Yes, that is correct.

Q. And would it be correct to say that Exhibits 63 and 64 show the difference in investors' appraisal of risk between various classes of companies including all of the securities which they have outstanding?

A. Yes, that is correct.

Q. Do those tables in those two exhibits, in your opinion, disclose that investors do carefully appraise the risks in these various types of companies?

A. I believe that the data show that.

Q. Is there anything that you would like to add in connection with that answer with respect to Exhibits 63 and 64 relative to such appraisal of risk by industrials?

A. Well, I do not know that there is, except the one [fol. 7788] observation which I think I have made.

Q. I will ask you whether in connection with Exhibit 150 this was also prepared pursuant to a suggestion made by the Presiding Examiner? A. Yes, it was.

Q. I do not believe you have yet stated in detail what is shown on Exhibit 150. I think you should do that at this time.

A. Well, at the time of the direct testimony I was asked whether I had any information in regard to recent issues that might have been brought out to the public.

I answered that I had not tabulated such data because in my study I was considering stocks that were outstanding and the quotations thereon.

This tabulation on common stock was too—

Q. (Interposing) Exhibit 150?

A. (Continuing) —of Exhibit 150 was to bring out the experience on those new issues of electric and gas utilities which I could find that had come to the public during the years 1935 to 1940, both inclusive.

Trial Examiner: The inquiry about the cost of financing [fol. 7789] through the issue of common stock was, of course, prompted by certain data contained in your Exhibit No. 65 which contemplated the possible refinancing of the Parhandle Eastern Pipe Line Company on the basis of bonds and common stock?

The Witness: Yes. Well, the point was that I could not answer the question because I did not have such material in any of the three exhibits, 63, 64 and 65, so I fabricated this information.

By Mr. Wheat:

Q. On Exhibit 150?

A. On Exhibit 150 and, believe that at least so far as our records are concerned that it is an all-inclusive list so far as the new issues of common stocks of Electric and Gas Utilities companies are concerned.

Q. Mr. Coffman, the data contained on Page 1 of Exhibit 150 is derived, is it not, from a publication of the Public Utilities Division of the Securities and Exchange Commission? A. Yes, that is correct.

Q. What about the data shown on Table 3 for the interim period 1941? Is that obtained from the same source or from other records and published data?

A. No, that information contained on Page 3 of Exhibit 150 is taken from the material which was in our files, which [fol. 7790] were prospectuses and our own records on such issues.

Q. Yes.

Now, during your cross-examination you were asked in respect to Chart No. 26 of Exhibit 65 why you included Southern Natural Gas Company and the Interstate Natural Gas Company.

Is it a fact, Mr. Coffman, that you took and included in that study all companies on which information was available by which you could make this study and the calculation?

A. Yes, sir, that is correct.

Q. And in that connection, did you find that information was available with respect to Southern Natural Gas Company? A. Yes, sir, it was.

Q. And with respect to Interstate Natural Gas Company? A. Yes.

Q. As a matter of fact, is the fact that Southern Natural Gas Company has encountered certain difficulties a fact in your estimation which should lead to its exclusion from such a study?

A. I did not think so. What I was attempting to do in this study was to get as broad a picture of the natural gas pipe-line companies as I could.

Now, the mere fact that Southern has had some financial [fol. 7791] difficulties and some later difficulties, so far as gas reserves are concerned, was just as important to me, so far as viewing the hazards of the industry were concerned as to look at any other company that was having an entirely different and much more favorable experience.

In other words, I wanted to have an entire look.

Q. Well, is it a fact that the Interstate Natural Gas Company has 100 percent common stock?

A. Yes, that is correct. Its capital structure is entirely composed of common stock.

Q. And did you find that its over-all ratio was practically the same as the common stocks of the other companies on the average? A. On the average, yes.

Q. Now, would it be your view that if you were to leave out any of these companies you would distort the picture that you were able to obtain?

A. Well, the only factor that I considered was that the difficulties that have been encountered by Southern Natural, I believe, in large measure account for the fact that investors require a higher earnings-price ratio and yet if the hazards faced by that company are hazards that can be faced by any company in this industry as time goes on, it seems to me to represent a reaction at a given time where such conditions actually exist.

[fol. 7792] On that basis, so far as considering the industry as a whole is concerned, I see no more reason to eliminate Southern Natural from the comparison than I would to eliminate Interstate Natural which happens to be on the low side, because it is ideally situated from a capital structure and from an operating standpoint. They are both important.

Q. As a matter of fact, Mr. Coffman, a rough calculation which I have just made discloses that if you eliminate those two, you have an average of 12.75 as against the average, including them, of 12.99.

I wish you would check me on that and tell me whether that is correct.

A. I do not recall what figure you gave. I have taken here, if I understand your approach correctly, Memphis Natural Gas Company at 15.10, El Paso Natural Gas Company at 11.62 and the Panhandle Eastern figure of 11.53.

I totaled them and took an average.

Q. What did you get?

A. I got 12.78. I do not know whether that is the figure you got.

Q. I may have mistaken that last figure. I had 12.75, but it is close enough. In other words, it was 12.75 or 8 against the 12.99 that you found in using the five companies. Is that correct?

[fol. 7793] A. Yes, that is correct.

Q. Would you consider those two figures reasonably consistent with each other?

A. Yes, I think they are.

Q. All right. Now, there was some other question raised, I believe, with respect to the data contained on Charts Nos. 19 and 20 of Exhibit 65 about the use of simple averages as against weighted averages. Have you anything to say on that subject?

Did you use weighted averages?

A. In Exhibit 65 as related to common stocks, I used a straight arithmetic average.

Q. Why?

A. Because where you have different companies that you are considering, such as was the case in the material contained in Exhibit 65, companies of different capital structures, some with bonds and common stock, others with bonds, preferred stocks and common, others with common only, it was my opinion that the only place where [fol. 7794] a weighted average could be used would be where you are talking in terms of over-all capital because there you are considering all earnings available for capital and you are considering all capital.

In the case of common stocks, because of the differences in capital structure, I believe that the only way to get a fair comparison was on the basis of considering one share in each company and making a tabulation on that basis through an arithmetic average.

Q. What do you mean by considering one share in each company?

A. Well, I mean that what I did was to assume that if a company earned \$3 a share and the price was a certain amount, I got an earnings-price ratio. I did the same on each of the companies. I totaled up those earnings-price ratios, which is a straight arithmetical average, which is assuming one share of each.

Now, if you wish to make a weighted average under such circumstances, then it seems to me that consideration should also be given weight to the differences in capital structure.

Up to the present time we have never been able to find out a satisfactory method of doing that, so I did not undertake to do it in this study.

Q. Do you feel that an attempt to get a weighted average [fol. 7795] age here would have any particular significance?

A. Well, if some suitable method could be worked out I would like to see the results of it wherein it takes into consideration a weight given to the differences in capital structure; so far we have not been able to get a satisfactory method, so the only one that I can use which is fairly satisfactory and simple is the straight arithmetic average and that is what I used in this case.

[fol. 7797] Q. You were asked some questions about the outstanding common stock of Panhandle Eastern Pipe Line Company and the amount of stock with respect to which prices were obtainable for your figure of investor's appraisal of risk.

Is it your view that the Panhandle Eastern market figures are reasonably used in obtaining the investor's appraisal of risk?

A. Well, it is my contention that so far as the stock outstanding in the hands of the public is concerned, the [fol. 7798] market quotations on such stock, whether it be 8 percent or a larger percent, are the only figures that are available to register such an indication.

In other words, they are all the quotations that were available through transactions in the market on such stock.

Q. And in your opinion, do they satisfactorily register such situations as you were attempting to determine?

A. For all those transactions they certainly do.

Q. Now, Mr. Coffman, during your cross-examination I believe that you were asked certain questions in which mention was made of a method of rate establishment which I believe was referred to by both Commission counsel and yourself as the "classical method."

Do you recall those references?

A. Yes, I recall them.

Q. As a matter of fact, I believe, you used that term, yourself, from time to time during your cross-examination. Is that correct?

A. I believe I did, yes, sir.

Q. In doing so you were glad to adopt Commission counsel's term?

A. Well, I think we were talking about the same thing.

Q. Well now in order that the record may be entirely clear in respect to what you were referring to, Mr. Coffman, I want to ask you at this time to state your understanding of the meaning of this term "classical method of rate making," as you used it in your answers to Commission counsel's inquiries.

A. Well, I understood it to be a method whereby an attempt was made to determine what is commonly called a "rate base" and, in addition, there was an attempt made to determine what was called a "rate of return" which would be a percentage figure and the multiplication of this percentage rate, so determined, against the rate base so determined was to lead to what would be considered a fair return which, presumably, would be sufficient to cover the various operating expenses, taxes, reasonable depreciation, and allow something over which would be equivalent to a return of capital and a fair return thereon and that, also, I believe takes into consideration any interest that may be taken into consideration on funded debt.

Q. In other words, I take it you believe that method includes a determination of the operating expenses, the

taxes, proper depreciation amounts and this item which you designated "fair return", is that so?

A. That is correct.

Q. And the latter ~~item~~ consists of the result of a multiplication of two figures, one of which you have mentioned as "rate base" and the other which you have mentioned as "fair rate of return"?

[fol. 7800] A. That is correct.

Q. Is the latter figure a percentage figure?

A. That is a percentage figure.

Q. Then, this figure of fair return, I believe you just stated that, under the classical method of rate making, that would include sums necessary to pay the fixed charges on net capital?

A. Yes.

Q. In your view would this method of determining a rate base and multiplying it by a percentage rate of return be an essential part of what you term the "classical method"?

A. Yes, it very definitely is.

Q. Now, when you in your answer a few moments ago used the term "rate base", did you mean to imply any special type of rate base or a rate base arrived at by any particular means or method of calculation?

A. No, there have been various approaches from time to time. I have no particular brief for one or the other.

There has been the original cost less depreciation, for example, and the reproduction cost new and prudent investments. There are a number of different approaches that have been made.

So far as I can see, the only point to be sure of is that [fol. 7801] if the base figure that you get actually represents or approximates the capital that was invested in the business, it seems to me any method, if properly used, would give you a satisfactory figure.

Q. When you say "properly used" what do you mean? A. I mean if properly determined.

Q. In other words, I take it you mean by your answer that you do not, in speaking of the classical method, limit your rate-base item to some particular type of rate base?

A. That is correct.

Q. Would that be true whether that rate base were called "fair value" or whether it was arrived at on an investment basis or otherwise?

A. Yes, I say that if the figure that is finally determined is as careful of approximation of the capital that has been invested in the business, that should be a satisfactory basis from which to work.

Q. Well, would you say that the ascertainment of such a rate base is an end in itself in this classical method of rate making, as you have used that term?

A. No, I do not see that it can be an end in itself.

Q. Why not?

A. Well, because, as I have just pointed-out, you have to have in addition to that the determination of a return, [fol. 7802] that is, rate of return, which is the percentage figure to which I referred.

The rate base, in and of itself, without this other determination, would not get you any place. There are the two factors.

Q. Well, would the rate base, as such, and standing alone, have any significance at all in your mind?

A. Well, in and of itself I would not say that it did.

Q. Well, do you consider the determination of some rate base an essential in the classical method as you have used that term?

A. Yes, you have to determine a rate base in which to have a figure on which to apply this percentage, which is rate of return.

Q. Well then, I take it you, also, consider this element of percentage, a fair return, as essential in that method?

A. Very definitely as essential.

Q. And would the same statement you made with respect to rate base, standing alone, as being a figure without significance, apply, also, to this fair rate of return element?

A. Well, it seems to me so, because a rate by itself with no base to which to apply it is of no value. The two must be related together if you are to get the result that [fol. 7803] you are seeking.

Q. In developing a fair rate of return, what, in your estimation, would be necessary were you using the classical method of arriving at allowable rates?

A. Well, to determine the final amount of dollars, you have to have first determined the rate base and, secondly, to have determined the rate of return.

It is presumed when one is multiplied by the other that you will receive a dollar figure which should be sufficient to cover all of these items we just mentioned, namely, the operating expenses, the taxes and so forth and allow return of capital.

Q. Well, the return, as such, is the only item in that group that is arrived at by the multiplication of rate base by rate of return? A. Yes, that is correct.

Q. Now, will you proceed to answer my former question as to what would be necessary in your mind under the classical method to arrive at a proper fair rate of return?

A. Well, I do not know whether I just get the whole of your question.

Q. Or would it be necessary, Mr. Coffman, in your opinion, to make the same kind of a study as you have made here in order to arrive at a fair rate of return after you have got a rate base?

[fol. 7804] A. Well, I feel that so far as the objective approach is concerned that this method that I have used takes, very definitely, a realistic approach to the problem and is one method of ascertaining the dollars needed to meet the requirements to return to cover all of the expenses and cover the depreciation and allow a return to the stockholders in the invested capital.

Q. Well, this dollars-needed figure is the result that you are after?

A. That is true, in either case. In the multiplication of the rate base against the rate you are attempting, by one method, to do that and the method I have used is just another approach.

Q. Well, do you know of any other objective method of obtaining a proper fair-rate-of-return figure than to multiply against the rate base in order to get this dollar-figure return, which would not be apt to take into con-

sideration the same type of things that you have taken into consideration in your direct approach to that return figure?

A. Well, it seems to me that it will be necessary in any event to ascertain what the investors say in regard to the securities in the particular branch of the business.

The purpose of my undertaking this study, giving attention to the investor's appraisal of risk was to ascertain to the best of my ability what the investor actually says [fol. 7805] he requires so far as his capital in this particular kind of risk is concerned.

It seems to me that in any approach, consideration would have to be given to those kind of data.

Q. Is there any other way that you know of, Mr. Coffman, under our present economy, to obtain financing for such a corporation as Panhandle Eastern Pipe Line Company, except going into the market and obtaining the funds necessary from the money markets?

A. Well, so long as various industrial and public-utility corporations are relying for their additional financial requirements on the [various] private investors, then their appraisal of the risks must be taken into consideration.

In other words, if they are going to be the source of capital, then one must try to ascertain what they require by way of an earnings-price ratio to see whether or not they would be willing to put in additional capital and at what ratio.

Q. Well, is there any other source of such capital except such private investors under our present economy?

A. There are not any other sources at the moment. There are some institutions buying securities, of course.

Q. Are they not private investors?

A. Well, they are private investors, but I merely want [fol. 7806] to draw the distinction between an individual that might buy 10 shares of something; let us say, and an institution which would have far larger sums and could invest larger sums.

Q. Well, purchases made by these larger-sum investors go into the data which you use in such an earnings-price ratio study, do they not?

A. That is right. I think the same facts hold true and they are reviewing exactly the same data as the other investors.

Q. In order to obtain a fair rate of return to apply to any given rate base, whether it be low or high, do you know of any other method of obtaining the percentage except to look at what private investors will demand in the market?

A. No, I do not. I do not know any exception.

Q. Well, is it a fact, then, that regardless of whether you use a direct approach at the dollar figure of return or whether you use this classical method, as it has been termed here, of rate base times fair rate of return, you must ascertain these same facts?

A. It seems to me that you must.

Q. Do you believe that that is a necessary condition precedent to the obtaining of a proper fair-rate-of-return figure?

[fol. 7807] A. Yes, I do.

Q. Now, when you talked about fair rate of return, did you refer to any particular percentage rate of return which may have been used in any particular case, for instance?

A. No, I did not have that in mind. I have placed in this Exhibit No. 65 a short quotation from the Bluefield Case.

The reason that I made the reference to it was to see whether or not any factors had been listed as to the proper ones to be considered in a consideration of rate-of-return case.

I was not interested in whether the rate was determined at one figure or another. I was trying to find a guide. It seemed to me that there were a number of items which were very specifically listed which were reasonable guides to this over-all problem. That was the purpose of the reference.

Q. Under your approach, could any specific percentage be made applicable to all cases?

A. I do not think it could. I think that it is determined by the facts in each situation as, I think, has been indicated in the cases.

Conditions may vary from one part of the country to another as between one company and another and those

[fol. 7808] various factors would have to be taken into consideration to arrive at what would seem to be a fair conclusion?

Q. Well, if a study of this objective data is made in order to arrive at a fair rate of return, are we to understand from your previous answers that you would, in your own mind, reject this so-called classical method?

A. Well, I do not think I have said that anywhere. I have merely made the contention that in this over-all approach it seemed to me that there was room for an additional approach of the problem and in the work that I have been doing on the subject it looked to me as if the approach I had used in Exhibit 65 was a helpful contribution to the general subject and, therefore, I made the study on that basis.

Q. Do you know of any other method, general method of obtaining the objective data which you believe to be necessary?

A. At the moment, I do not know of any. What I have attempted here was to approach the problem on the method described and make it as concrete as I could through the statistics and graphs which show exactly what I have in mind to get at an objective approach with a realistic result.

Q. Do you believe that an objective approach is necessary whether you use this direct approach method or [fol. 7809] the classical method?

A. I think it is, yes.

Q. Under your views of this matter, would it make any difference what particular type of rate base were adopted by a regulatory body provided the rate of return were developed on a basis of reasonable objective data?

A. Well, in my particular analysis I have not determined a rate base but if the figure that I have determined as the amount needed were correct; then, if someone would give me the figure for a proper determination of a rate base, it would be a simple matter to determine what the rate of return should be.

In other words, the rate base under my method could be one figure or another, but if the dollar amount that has been determined would prove to be accurate, then the

rate would be determined depending on which figure or which size of figure you had for the rate base.

Q. I believe you said a few moments ago that you did not cite this Bluefield Case because of any particular rate of return used there. What did you mean by that?

A. Well, the only thing that I wanted to get from any references was such indication as to the items that were believed to be necessary in consideration to treat this problem and the one reference that I made on Page 3 in [fol. 7810] Exhibit 65 I thought pretty clearly specified those various items that one had to take into consideration if they were going to deal with the problem of rate of return.

Q. Well, what were those items that you had in mind?

A. Well, for example, quoting from this quotation:

"A public utility is entitled to such rates as will permit it to earn a return on the value of its property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties."

Now, so far as that item is concerned, when I was looking at the investor's appraisal of the risks of capital, considering various classifications of the public-utility industry such as water companies, electric companies, manufactured-gas companies, natural-gas companies and natural-gas pipe-line companies, I thought in concrete form I was following exactly what that statement meant.

Q. Well, were you there searching for some source of data on what are the considerations in the market of corresponding risks?

A. Yes, I was trying to get at that very point on a statistical basis.

Continuing further, "but it has no constitutional right [fol. 7811] to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures."

Well, in my study, no such ventures were listed because I combined the analysis of investor's appraisal of risks altogether to the public-utility industry in its various classifications which I have already mentioned.

Continuing further: "The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate under efficient and economical management to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties."

Well, there again, speaking of efficiency of management, the purpose of Chart No. 8 in Exhibit 65 in which I made an analysis of the operating ratio and compared that with a similar figure for the industry was to get some idea of whether or not this company could be said to be an efficiently-managed company.

I thought in view of the comparison of ratio that there was some indication of that fact. So far as the financial soundness is concerned, I was attempting to get at that through the analysis of these figures in the June 30, 1941, statement and through an analysis of the operating figures as shown of the same date.

In other words, my whole approach as I have described, [fol. 7812] was based on those figures.

Q. And your approach was wholly an objective approach, was it not?

A. Yes, so what I did was to find in this Bluefield statement a number of items which had been found by experience, apparently, that should be taken into consideration to arrive at a sound conclusion.

Q. And you believe that they were taken into consideration through your study?

A. To the best of my ability I attempted to do exactly that, sir.

Q. Mr. Coffman, is there any way that you know to force investors to purchase the securities in such an enterprise as this and thus finance its operations?

A. No, I do not see that there is any way that you can force a person to invest money in anything. In other words, when you sell a share of stock or a bond you have a commodity which, for all purposes, is like any other. If it is priced right in view of the value you think you are getting, you are perfectly willing to make a purchase.

If you think it is overpriced, you will draw away from it and if it is underpriced, you rush to get it if you have

funds for investment, but I do not know how you can force anybody to invest money in anything.

Q. Can you ascertain the behavior of investors by [fol. 7813] a study of the money markets?

A. Yes, I think you very definitely can.

Q. And is that what you have done?

A. That is what I have done in these three exhibits.

Q. Do you know of any other method which offers a similar opportunity to derive the earnings figure consistent with the statements mentioned and quoted by you from the Bluefield Water Works and Improvement Company Case?

A. I do not believe I do.

Q. You recognize, of course, don't you, that there may always be differences of opinion by honest men in respect to the use of any particular factor or elements in such a study?

A. Yes, I think I have indicated that in answers that I have given.

Q. And you recognize, also, that different investigators may give different weight to different elements?

A. Yes, that is correct.

Q. In the absence of obtaining objective data in at least some degree approximating what you have tried to obtain, do you believe that there is any basis for use of judgment in arriving at the rate-of-return figure?

A. Well, I do not know exactly what you have in mind there, but I think it is commonly believed, today, that there has been a substantial decline in interest rates and [fol. 7814] if one studies indexes, particularly in regard to absolute money rates,—I mean by that something in the way of a call loan or a short-term commercial paper, or even the rate on Government bonds,—they will find that over a period of years there has been a substantial decline in interest rates.

From that knowledge, if they did not go on and make the checks that I have tried to make, you might well conclude that that was true, ~~not~~ across the board, of all investments.

What I tried to do in Exhibit 63 and the supporting material in Exhibit 64, was to ascertain whether, in view of

this decline, investors, when it came to corporate funds, were still analyzing these various securities on the basis of the risk-factor.

It seemed to me that coming right down as close as I have, that is, August, 1941, in spite of a down trend on all of these items, there is still an investor's appraisal of the risks of capital as demonstrated by the capital that I referred to yesterday on Page 23 of Exhibit 63, wherein, for the four-year period that I have there, although each of the items over a period of years might have gone down as between water companies, electric-utility companies, and so forth, nevertheless, as of today investors are still contending and requiring that the natural-gas pipe-line [fol. 7815] companies on the average have about 4 percent more risk than water companies.

The reason, presumably, for that is that investors feel that there is a greater hazard to an investment in the natural-gas business than there is in the water companies, so that unless a person reviewed that they might conclude that this decline in interest rates, just as I say, applied generally right across all securities.

I wanted to ascertain as a matter of fact whether that is true or whether investors right today are saying that if you want their money on corporate securities they require more on one kind of risk than they do on the other and, therefore, it seemed to me that an objective study was the only way to ascertain whether that was true or not.

Q. Well, would you say that your study is based primarily on an objective investigation of what such a company needs to earn and must earn as contrasted with an examination of what it might be merely entitled to earn?

A. Yes, that is correct.

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[fol. 7816] Q. Mr. Coffman, I think from your statements this morning that investor's appraisal of business varies, not only between classes of companies, but between companies of the same classes.

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The Witness: Yes, I think that is right.

Q. And varies also with time?

A. That is correct.

Q. Why does that investor's appraisal vary?

A. For one reason it varies because of changes in economic conditions as between one time period and between another time period. I have tried to make it clear that, so far as my own opinion is concerned that in one particular period, if economic conditions are on such a level that investors appraise the risk at a certain rate, that rate will hold good so long as there is no major change in any fundamental economic condition.

Now, if you come into a new period where there has been a change of a fundamental economic condition, such as [fol. 7817] in the present situation where we have, among other things, this emergency condition, a major change is taking place and investors, therefore, are going to appraise that change in economic conditions to the best of their ability because they believe thereby that the risks of their capital have changed to whatever extent they may appraise the hazard connected with this particular change in economic conditions.

Q. Do you believe that the method which you have adopted is a reasonable method of evaluating these changes in investor appraisal because of economic conditions?

A. Well, I think I make the statement a little stronger than that. What I say is that, so far as the investors are concerned, you have to study some particular phases wherein you can get an appraisal that they are making of the conditions at the time and in the investor's appraisal of the risks of capital, the only way I know that can be done is to see what actually is happening to the securities in the market by way of price changes.

That registers, on one basis I have used, namely, the earnings-price ratio, what the investor says is happening so far as the risk to his capital is concerned and that is appraised in these various earnings-price ratios that I have given in Exhibit 63 and have used in Exhibit 65.

Q. Without some such objective study as that, either on this method that you have used or on what you have called

[fol. 7818] the classical method, if you do not have some such study as that, do you believe you could reach the proper reflection of the economic situation except by pure accident?

A. No, I do not think you can. I say that regardless of which method is being used, if the particular analyst, to the best of his ability, will try to ascertain what the condition is as the investor is appraising it, they can take care of it perfectly all right.

I have got this statement here which I have written out which summarizes the thing about as good as I can state it and that is when the classical method is used, the same kind of an examination of surrounding facts is made as I have tried to make in this particular case—

Q. (Interposing) You mean “if that”, “unless that is made”?

A. (Continuing) Unless this is made. I do not care whether it is my method or the classical method or what method is used. It makes no difference but, I say it has to be done.

The mere multiplying of any given rate base by any given rate of return will produce a money figure equal to the economic necessities of the enterprise in question only by accident.

In other words, if you go on and arrive at the figure for your percent which does not take into consideration the [fol. 7819] investors' appraisal as they see it, then I do not see how you can arrive at a figure that is accurately appraising these changes in economic conditions, unless it should be accidental that the figure will come out on the same plane.

Q. Why do you say that?

A. I say this because it is not possible to know what the economic need is except as the result of some such study as I have made in this case, as represented by my three exhibits, Nos. 63, 64 and 65.

What I have tried to do is to attempt to develop adequate statistical measures of the factors influencing needed return. Now, if that is also done under the classical method, the result would be the same but, if it is not done,

then I say if the figure comes out to the same level, it is a matter of accident rather than a matter of examination.

[fol. 7820] Recross-Examination

[fol. 7850] Recross-Examination. (Further)

By Mr. Littman:

Q. Will you please turn to Your Chart No. 8 of Exhibit No. 65?

Now, during the course of your somewhat lengthy re-direct examination I believe you stated that this chart [fol. 7851] indicated to you that Panhandle Eastern Pipe Line Company had a more favorable operating ratio than other natural-gas pipe-line companies. Is that correct?

A. Yes, I believe I said that.

Q. And I believe somewhere in your testimony you stated that that indicated to you that Panhandle Eastern Pipe Line Company was efficiently managed. Is that correct?

A. Well, I do not recall as I said it that way. What I remember saying is that in comparison with the other pipe-line companies I thought there was an indication here that the operating ratio showed that the management of the Panhandle Eastern Pipe Line Company was more efficient than the average [cas] compared with this other index.

Q. In other words, in your opinion, the better the operating ratio of a company, the better its management?

A. Not altogether, because there are various ways of determining the efficiency of management, but from a statistician's point of view the operating ratio is one convenient method where you have only figures to go on as in contrast with making the examination of a plant and seeing just how it is run from, let us say, an engineer's point of view.

I will say that it is one guide, it is not the sole guide, but it is one indicator that can be used.

Q. So that this chart called "Chart No. 8" of Exhibit [fol. 7852] 65 indicates to you that Panhandle Eastern Pipe Line Company is efficiently operated as compared with other natural-gas pipe-line companies?

A. That is one indication and I say that not altogether because of the comparison but more because of the trends shown in the period of years covered, 1935 through 1940.

In other words, the decline in ratio of 58.2, let us say, to 38.5 would indicate to me that the management had been able to accomplish certain things by way of efficiency.

Q. Have you made any other investigation into the efficiency of the management of Panhandle Eastern Pipe Line Company?

A. Well, Mr. Littman, I, also, would include the facts shown in Exhibit Chart No. 16, for example, as, also, an indication that the management have been alert.

In Chart No. 16, Exhibit 65, showing historical cost of debt capital of the Panhandle Eastern Pipe Line Company from 1930 through 1941, there has been a decline in historical cost of debt and in 1941 that cost has been reduced to 2.74%.

I think that indicates the alertness of management in adjusting itself to changed financial conditions and I think that is a part of efficiency.

Q. And I presume, likewise, you would refer to the [fol. 7853] recent refinancing program put through by Panhandle Eastern Pipe Line Company in which it has reduced its over-all cost of money as is shown in the Securities and Exchange Commission's opinion which is Exhibit 147 in this proceeding, as a further indication of the efficiency of the management of the company?

A. I would say that that is a further indication of the alertness of the management, yes.

Q. And, as you testified the other day, the over-all cost of servicing all of the outstanding debt and securities under the pro forma statement, after the refinancing, related to the total capitalization is 6.6 percent.

Wasn't that the figure you used?

A. That was the figure I calculated for you, I believe.

Q. Yes.

A. Yes, I remember the figure.

Q. Now, adhering for the moment, however, to Chart No. 8 of Exhibit 65, in your judgment one company that has a better operating ratio than another company would, in your opinion, have better efficiency of management than the one with the higher operating ratio?

A. I would not restrict my answer quite that way. What I have in mind here is the trend, as much as anything.

In other words, it is not altogether a relation of 38.5 in [fol. 7854], 1940 for Panhandle Eastern Pipe Line against 51.3 that has significance, altogether; it is, also the trend that you find from 58.2 in 1934 to 38.5 in 1940.

Q. Well, you state in the text according to Chart No. 8, after making reference to the rising taxes, that "it is obvious that the rising tax burden is tending to offset benefits of efficient operation"; do you not?

A. Yes, that statement is there.

Q. So that from that statement would it be proper to conclude that you consider the favorable-appearing operating ratio of Panhandle Eastern over that shown by other pipe-line companies to be an indication of efficient management?

A. Well no, I do not quite see that line of reasoning from that statement. What I am attempting to point out in Chart No. 8, Exhibit 65, in the box containing "After Taxes", that beginning in the year 1937 that exhibit indicates to me that the increases in gross operating revenue were not entirely sufficient to take up increases in taxes.

Had it have been, the Panhandle Eastern Pipe Line Company would not have shown a change in direction and that is the only point I really had in mind on that exhibit so far as reference to taxes is concerned.

Q. Well, aside from the reference to the taxes, did you or did you not state in your redirect examination that the [fol. 7855] favorable operating ratio of Panhandle Eastern Pipe Line Company, as compared with other pipe-line companies, was an indication to you of the efficiency of the operation of Panhandle Eastern Pipe Line Company?

A. Well, as I say, I do not recall, but I say that plus the trend of the operating ratio for Panhandle Eastern, itself, indicates the fact.

Q. That is, they both indicate it?

A. They are a statistical method, but not the sole one, as I have said. There are many other ways of checking efficiency of management.

Q. But it is one of them?

A. From the statistical standpoint it is used by every investment analytical service.

Q. I hand you a written illustration for the purpose of enabling all present to follow the next few questions.

Now, Mr. Coffman, I want you to assume that we have two natural-gas pipe-line companies, "A" and "B", respectively. Company "A" has a total gross revenue for a given year of \$1,000,000 and Company "B" has a total gross revenue in the same year of \$1,500,000.

Notwithstanding the fact that both of these companies sell the same volume of gas, I want you to assume that Company "B" earns \$500,000 more revenue than Company "A", simply because its rates are exorbitant.

Now, I want you further to assume, as shown on the sheet which I just handed you, that the operating revenue deductions before taxes for each of these companies is \$500,000, leaving net revenue before taxes of \$500,000 for Company "A" and \$1,000,000 for Company "B".

Now, what is the operating ratio before taxes of Company "A", the one that has the reasonable rates?

A. Well, on this sheet, which is shown here, the Company "A" operating ratio before taxes is 50 percent.

Q. And what is the operating ratio before taxes for the company that has the exorbitant rates, namely, Company "B"?

A. Well, that is 33½ percent.

Q. In other words, Company "B" has a much more favorable ratio than Company "A", does it not? Is that right?

A. That is correct.

Q. Now, right there, a company that has exorbitant rates would have a tendency to show a more favorable operating ratio than a company that does not have such exorbitant rates? Is that correct?

A. Oh, in any of these comparisons where you are using a gross-revenue figure, if you change the two figures, you will get that difference in percent, surely.

[fol. 7857] Q. Well, it is a mathematical fact, isn't it, that the higher your revenue occasioned by high rates, why, the better-looking operating ratio you are going to have. Isn't that right?

A. Sure, occasioned by anything. You do not have to mention rates, occasioned by another fortunate circumstance, certainly.

Q. Now, after taxes we have, as shown in this illustration, for Company "A", the company with reasonable rates, a net operating income after taxes of \$400,000, whereas Company "B" after taxes of \$300,000 has a net operating income of \$700,000. I want you to assume those facts as shown in this illustration.

Now, is it correct that under those assumptions that Company "A" has a 60-percent operating ratio after taxes?

A. Yes, it is.

Q. And that Company "B" has a 53 $\frac{1}{3}$ percent operating ratio after taxes?

A. That is correct.

Q. Now, of course, the company that has exorbitant rates has to pay higher taxes, Federal income and Federal excess profits taxes than does Company "A", which has the lower rates. Isn't that correct?

A. Well, that is correct only under your assumption.

Q. You mean to say that a company earning exorbitant rates and exorbitant profits flowing therefrom will not have to pay more taxes, all other things being equal, than a company that does not have such a favorable situation?

A. No, you have corrected your first statement by saying "all other things being equal". The point I wanted to bring out was that the company could have higher rates and if the costs were higher it would have no higher tax because net income was high, because the costs offset the higher-income revenue rate.

Q. Well, of course, we are showing here what is shown for Company "B", namely, that the rates are, in truth and fact, exorbitant.

A. I do not mean to fuss, except that I thought that what you asked in your question was not confined to this example and I wanted to qualify my answer.

Q. I see. Well, we are still talking about the illustration. A. All right.

Q. Now, you notice the trend that results after the payment of these taxes, do you not, Mr. Coffman? You see, do you not, that the operating ratio of Company "B" has now gone up to 53½ percent and very closely approximates and comes much closer to the operating ratio, after taxes, of Company "A"? Do you see that?

A. Well, for this given example that is correct, but [fol. 7859] that is not in line with what I am talking about in Chart No. 8.

Q. Well, let us confine ourselves, for the moment, to the illustration. It is a mathematical fact, is it not?

A. Absolutely.

Q. That a company that is earning exorbitant rates will, because of that fact, pay more Federal excess-profits and Federal income tax than a company that, all things being equal, does not have exorbitant rates. Is that correct?

A. Yes, that is right.

Q. And, consequently, there comes a point after taxes where the two operating ratios will come pretty close together, notwithstanding the fact that one company has the exorbitant rates and the other company has not. Isn't that generally true?

A. Sure, that, mathematically, could be true.

Q. Yes. And what we have said, for purposes of this illustration, would be true even though both companies had exactly the same management? Isn't that true?

A. Both companies had exactly the same management?

Q. Yes.

A. Yes, that would be true. That is still talking under your hypothesis, of course.

Q. Now, I believe you made the statement this morning or possibly yesterday that Panhandle Eastern's common-[fol. 7860] stockholders are not so well situated after the

recent refinancing than they were before. Is that or is that not a correct interpretation of your remarks on that subject yesterday?

A. Well, not quite. I think I know the matter you are referring to. In discussing the percentages which were shown in the Securities and Exchange Commission's release containing actual consolidated capital figures in the pro forma, it was pointed out that on the pro forma—I do not recall the exact percentages at the moment—but the pro forma was 34 percent as against 43 percent.

It showed common stock and surplus to be 34.99 as against the actual of 43.62.

Mr. Wheat: Mr. Littman, I did not recall the witness said anything about favorable or unfavorable. Was that your question, more favorable or less favorable?

Mr. Littman: Yes.

Now, I gave the witness the opportunity and I want him to state whether or not that is a correct interpretation.

Mr. Wheat: I did not recall that and I wonder—

Mr. Culton: (Interposing) My recollection is that he said "further removed."

The Witness: Further removed is what I said, if you will look at the record, I think. I will be glad to discuss it with you again if you wish to have me do so.

[fol. 7861] By Mr. Littman:

Q. Right there, I think maybe you have cleared me up. You did say yesterday that after the refinancing, as shown in Exhibit 147 on Page 17, by the pro forma statement the common stockholders' equity represented 34.99 percent of the total capitalization, whereas before their equity represented 43.62 percent.

Now, you stated that, didn't you?

A. Yes, I did.

Q. Now then, you made some remark with respect to the fact that the common stockholders were further removed from the—well, suppose you tell us what you did say on that.

A. What I said was that with this shift in the common stockholders' position under the pro forma as against the

actual, there were now more senior securities ahead of their equity, therefore, they were further removed.

What I meant was that increasing the senior capital first by way of debt to 43.90 percent as against the present of 32.28 percent and in the preferred stock, which now carries a sinking fund, so I put it over in senior capital classification, to 21.12 percent against 18.10.

It seemed to me that the investor looking at these additional senior securities going out, all, now, providing for sinking funds, would feel he was further removed than heretofore, so far as his position was concerned. In other [fol. 7862] words, more preferences are now outstanding against him, either in case of liquidation or otherwise than were before in the case of these percents.

Q. Now comes my question: Do you mean by that to infer that the common-stockholder is not so well situated after the refinancing as he was before?

A. Not necessarily. I would say that that will be a matter of appraisal on the part of the common-stockholder for this reason, it may be that advantages will flow from the new financing from an earnings standpoint.

Q. Well, you know that will be a fact, don't you?

A. Well, just a moment. I do not know anything until it happens, really, but to continue in answer to your question, the common-stockholder will try to ascertain whether or not, because of earnings coverage, he will still have sufficient advantage so that even though risk and liquidation are now larger and senior capital is larger than before, he will not, over the period, be seriously handicapped.

That will be a matter for him to appraise.

Q. Well now, Mr. Coffman, I take it from the answer which you just made that you are not prepared to state at this time whether the common-stockholders of Panhandle Eastern Pipe Line Company were better situated before than after the refinancing.

[fol. 7863] In other words, you are unable to state whether there has been any change in the situation. 7

A. Well, to take all factors into consideration, I would not want to say at the moment, but if you will specialize on a few factors, you now have more bonds outstanding

carrying a sinking fund and you, also, have a preferred stock out now for the first time that carries a sinking fund.

Now, so far as the common-stockholder is concerned, he does not like to see too much of this but that is one factor.

Now, if, on the other hand, from the earnings standpoint, by savings in financing, he would get an offsetting factor, well, maybe the things will balance out.

That is the reason I said yesterday that I would like to wait and see what the investors in the market say about this. I do not know at the moment.

So far, outside of those bid prices I gave you this morning, the price has not changed much. Maybe it will change more, maybe they will say it is even.

Q. In other words, you would not want anyone to construe your remarks on this subject as meaning that you consider the refinancing as having adversely affected the common stock of Panhandle Eastern?

[fol. 7864] A. No, I do not believe so. As I remember, when I made that statement baldly, I thought Mr. Wheat interrupted to ask whether I was meaning to imply that because of the fact that the S. E. C. had permitted this registration I was in some way condemning the plan.

All I say is that any security, any capital setup wherein you get less and less equity, other things being equal, you get into more of what is called a leverage situation and taking the S. E. C. statement from time to time that they thought in many of these companies there should be more equity capital, it seemed to me, for the moment, this was a little in the other direction, but I do not believe I implied, nor did I say that it had worked a hardship on anybody.

By Mr. Littman:

Q. In other words, Mr. Coffman, there are favorable aspects and some unfavorable aspects, probably, in your opinion and the two may counter-balance each other.

A. That is right, and I believe that on that score the S. E. C. in its own release made some comments that there were a few things they did not like so well but under the

[fol. 7865] circumstances seemed it to be a perfectly reasonable plan.

Q. With respect to the common stock?

A. Yes, surely.

Mr. Lee: I just wanted to ask you, Mr. Coffman, if, as an investment counsellor you would not have given a great deal of consideration and emphasis in your analysis of the size of the common-stockholder after the consolidation as against before, whether or not you would not have given great consideration to the tremendous improvement in the Panhandle Eastern Pipe Line Company in so far as it was becoming a continuous system owned and operated by one management, and that this bottle-neck that has existed for some years between the terminus of Panhandle at Dama, Indiana, and the Detroit market was being eliminated.

Didn't you consider that tremendous advantage that ought to result in increased earnings and ought to make a big appeal to the common-stockholder as against the other situation that you mentioned?

The Witness: Well, I think those factors, Mr. Lee, very definitely would be taken into consideration and weighed. I, at the moment, for this particular study, did not do it. The same would go in the change in capital structure, for instance, on the participation feature.

I mean, here is another factor that has been changed as [fol. 7866] between the common and preferred, so I could not say at the moment the relative weights of either. The observation I was trying to make was merely the one that in reducing the percentage and having more senior capital ahead with sinking funds, the common-stockholder was somewhat more removed.

Mr. Lee: Yes, but being somewhat more removed, any detriment that he may suffer by reason of that statement, wouldn't you in all fairness have to consider the benefits that offset that further removal?

The Witness: Oh, very definitely. I have no argument on that, because I have not weighed those various things and I say the common-stockholder will consider all of them as well as the investment analyst and that is the reason I raised the question as to whether there had been a change in price of common stock in the quotations.

Maybe when they get all through with the analysis the benefits will outweigh any detriments or maybe they will do better than that. I merely wanted to wait and see what the market actually said and the mere fact that it is down two points does not indicate to me at the moment one way or another of that, because it will take a little time for them to assimilate these various factors and perhaps make a new appraisal as to the way they see the consolidated company and the new capital structure.

[fol. 7877] By Mr. Littman:

[fol. 7878] Q. Mr. Coffman, just before recess, we were discussing the changed situation of the common-stockholders of Panhandle Eastern after the refinancing.

Now, isn't it a fact that before the recent refinancing which is reflected in the Securities and Exchange Commission opinion, Exhibit No. 147, the common-stockholders had to give up one-third of all earnings in excess of \$1.50 per share before those earnings could be distributed as a dividend to them?

A. There was the participating feature in which part of the earnings were distributed to the preferred and the remainder to common over and above the \$1.50 on common.

Q. In other words, the old preferred stockholders, that is, the Class A preferred stockholders, were entitled to receive one-third of the earnings in excess of \$1.50 per share on the common stock?

A. That is correct.

Q. Now, that feature is no longer present in the preferred stock of Panhandle Eastern under the new refinancing, isn't that right?

A. No, that is correct, but there are other features, of course.

Q. But confining ourselves for the moment to this feature, the holders of the new preferred stock which will supplant the old Class A preferred stock are no longer [fol. 7879] entitled to participate in the dividends of the common-stockholders, isn't that right?

A. That is correct.

Q. And, of course, that factor places the common-stockholders in a better position than under the situation where there existed a participating preferred stock?

A. Yes, so far as that one stipulation is concerned, it is a benefit to the common-stockholder.

Q. I believe you stated this morning on redirect examination that you could determine what the proper rate of return should be if you were furnished with the proper rate base. Is that correct?

X. Well, not exactly, Mr. Littman. } What I think I said was that if, by my approach, it were found that all the figures used therein were correct, then my resultant figure, if I knew or were given a rate base, could be used to determine the rate.

In other words, if it were granted or found to be correct that a certain sum of money, \$5,064,000 were correct, I merely say that dividing that figure which I find by my approach by whatever rate-base figure is given me will enable me to tell whether it is a $6\frac{1}{2}$, 7 or $5\frac{1}{2}$ rate.

Q. You have faith in the accuracy of your figures, have you not?

[fol. 7880] A. Yes, based upon my calculations as considered in Exhibit 65, I have made a calculation which I think is necessary for the management to have by way of earnings.

Q. Will you please refer to the figure or figures in your Exhibit No. 65 that can be relied upon as the figure to be used to compute a percentage rate of return in connection with a given rate base?

Mr. Wheat: Did you refer to Chart 36 or Chart 37?

Mr. Littman: I began to refer to Chart No. 36. I think he will probably want to refer to one figure in Chart No. 36 and possibly to one in Chart No. 37.

The Witness: Well, the figure in the chart would be \$15,520,855 which, applied to whatever the rate-base figure is, would give me a percentage so that that percent times the rate base would give me the total operating revenue.

By Mr. Littman:

Q. I think you probably misspoke yourself. Don't you mean to say you would use the figure of \$4,993,511 shown in your Chart No. 36?

Mr. Wheat: Or the \$5,064,821 shown in Chart No. 37?

The Witness: Yes, I beg your pardon.

By Mr. Littman:

Q. In other words, the latter two figures would be the ones that would be used in making such a calculation for the purpose of securing a percentage rate of return?

[fol. 7881] A. Yes, that is correct.

Q. In other words, if I correctly understand you, if the Commission were to make a determination of a certain rate base then you would divide that rate base into the \$4,993,511 figure referred to in Chart No. 36 of Exhibit 65 as "a fair return to investors" and obtain in that manner and by that calculation, a fair percentage rate of return under your method?

A. Yes, that is right, under my method.

Q. And under the assumption shown in Chart No. 36?

A. Yes, that is correct.

Q. And you would do the same if you wanted to follow the so-called actual figures which you used for Chart No. 37?

A. Yes, that is correct.

Mr. Wheat: May I ask just to clarify that, what you mean is that you would use your item of over-all current capital requirements as the dividend in that mathematical computation?

The Witness: That is the figure into which I would divide this figure that would be determined as a fair rate base.

By Mr. Littman:

Q. Mr. Coffman, I have before me a photostatic copy of an exhibit which was prepared by you and presented [fol. 7882] before the Public Utility Commission of Pennsylvania in a rate hearing involving the rates of Pennsylvania Power & Light Company.

I hand you a copy of this exhibit and ask you whether it is what I have just described, subject, of course, to check?

A. Yes, it is.

Q. I refer you to Page No. 53 of your exhibit in the Pennsylvania Power & Light Case and I read you the following statement:

"It is assumed here that the capitalization of the company is properly related to the rate base or fair value. If 'prudent investment' had been exercised by the company at the time the properties were acquired, then it must follow that the capitalization presently outstanding would coincide with a fair rate base or fair value on which the company is entitled to earn a fair rate of return."

Have I read correctly from Page 53 of the photostatic copy of your exhibit? A. Yes, you have.

Q. That was your testimony in the proceeding before the Pennsylvania Utility Commission, was it not?

A. Yes, that is correct.

Q. Incidentally, your study which was presented before the Public Utility Commission of Pennsylvania, to [fol. 7883] which I have just referred, is similar to the one which you have presented in these proceedings in Exhibit 65?

A. It is in most respects similar, yes.

Q. When was your testimony presented to the Pennsylvania Public Utility Commission, approximately?

A. About three or four months ago.

Q. At any rate, it was within the past six or seven months?

A. Yes, that is correct.

Q. Now, during your redirect examination, you made numerous references to earnings by other utility companies. I would like to ask you whether you agree with the following statement which appears on Page U1-3 of the August 29, 1941, issue of Standard & Poor's Industry Survey—Utilities:

"The natural gas industry is probably the best situated of the various divisions of the utility industry at this time. It will benefit materially from rising general industrial activity and operating expenses are largely fixed. Thus, even with heavy excess profits taxes, any decline in profits should be held to moderate proportion."

Do you agree with that statement?

A. Not all of it, no.

Q. What part of it don't you agree with?

A. May I see it, please?

Mr. Littman: Yes. (A document was handed the witness.)

[fol. 7884] Mr. Wheat: Did that say "natural gas distributors" or "natural gas pipe line companies?" I was talking at the time and did not hear.

Mr. Littman: I thought I read it exactly as stated.

Mr. Wheat: Would you mind reading that?

The Witness: This particular statement applies to the whole industry with no attention whatsoever given to distribution companies or transmission companies or anything else.

By Mr. Littman:

Q. But it includes, of course, natural-gas pipe-line companies?

A. It is talking about the industry, over-all, that is correct, but no particularizing on pipe-line companies at all.

Q. And the Federal Power Commission Annual Report to which you referred in connection with a purported 27-year life of reserves was also referring, was it not, to the over-all natural-gas industry?

A. Yes, it was. In this particular statement, as I say, from an over-all standpoint wherein it refers or makes this remark:

"It will benefit materially from rising general industrial activity and operating expenses are largely fixed". I, so far as discussing a natural-gas pipe-line company, would (fol. 7885) not agree with that latter statement.

For the industry as a whole, including all divisions, it is a generality.

Q. What natural-gas companies do have fixed expenses, Mr. Coffman?

A. I do not know that any of them do.

Q. Then if that is a fact, that part of the statement to which you just referred is entirely erroneous, is it not?

A. As I say, I do not agree with it.

Q. You are Vice President of Standard & Poor's, are you not, that publishes this document to which reference has just been made?

A. Yes, I am.

Q. And it is published for the consumption of investors and persons interested in making investments?

A. Well, it is a publication which, I say, is available to the public regardless of whom they may be. They may be investors, business men or any other person who has the price to buy the service.

Q. When you put this industry survey out on the market and sell it to the investing public, you, as Vice President of Standard & Poor's, fully expect investors to rely upon it, do you not?

A. I would not say we expect them to rely upon it. [fol. 7886] It is just one source of information like a newspaper. We do the best we can in publishing information, in tabulating it and correlating it. We expect the investor to use his best judgment in view of the information supplied to him.

Q. Do you mean to say you expect the investor to make his own investigation?

A. It is his own money so he certainly should use his own judgment.

Q. Does your company, Standard & Poor's, operate under the Investor's Advisory Act?

A. Yes, it does.

Q. However, you do agree with the balance of the statement other than that part which you read in connection with the fixed expenses?

A. Yes, for the industry as a whole, not making it definitive as to various divisions of the gas industry.

Q. But including, of course, natural-gas pipe-line companies?

A. It is looking over the entire group, the entire industry.

Q. Including natural-gas pipe-line companies?

A. That is correct.

Q. You also testified in redirect examination with respect to your reliance upon the Ralph E. Davis statement [fol. 7887] of "more than 25 years" in fixing a term of years over which you were going to amortize the fixed capital of Panhandle Eastern, a period over which you expect the gas reserves of Panhandle Eastern to be exhausted, is that correct?

A. Yes, that is right.

Q. Now, did you make any investigation of the opinion of Panhandle Eastern Pipe Line Company's management with respect to the life of its properties?

A. No, as I think I have stated, the information that I had so far as the company was concerned, came from its published reports and so far as information otherwise is concerned, it came from our files and public information.

Q. Now, Mr. Coffman, you are [no] so greatly wedded to that 25 years that you would not change your mind about it if someone would present you with cogent proof that the company itself proposes to operate beyond 25 years and could, if it wanted to, operate beyond 25 years?

A. Well, if any engineering study can be developed, so far as that particular invested capital is concerned, which would show that 25 years was inaccurate, I would assume that was a new fact that had come to light and would be taken into consideration.

Q. And you would be glad to revise your estimate to that extent, would you not?

[fol. 7888] A. That is correct.

Q. If the President of Panhandle Eastern Pipe Line Company had testified before the Securities and Exchange Commission to the effect that the general Hugoton area includes the counties of southwestern Kansas and, in addition, Texas County, Oklahoma, and parts of Sherman and Hansford counties, Texas, and with that definition of the Hugoton area, it is his judgment that if he were assigned the problem of obtaining additional gas reserves to meet the present indicated requirements of this company for 30 or 35 years, it could be done on a favorable and economical basis, what would your answer be?

A. Well, I think, Mr. Littman, we are talking about two different things there.

In this particular instance, I am talking about the reserves presently owned by Panhandle Eastern which are presumed, until a different study proves a different result, to last 25 years.

Now, if in the general vicinity of their reserves, there are other reserves which would last longer and such other reserves are acquired and the geologists agree that 30 to 35 years on those new acquisitions will work, I should sup-

pose that was the figure to use on those new acquisitions but I draw the distinction between that and the reserve the company has at the present time.

[fol. 7889] Q. In other words, you confine your amortization period to the life of the reserves presently owned and controlled by Panhandle Eastern Pipe Line Company?

A. Yes, very definitely, for the reason that I think I gave you earlier that although there may be some reserves available in this general area, if they are not now acquired by Panhandle, they may be acquired by competitors so that it is not certain a few years hence that one could acquire anything.

Maybe they can but after all, there are competitors in this business. There is no assurance because someone says they are there and available that they will be there next week, it seems to me, unless they are actually acquired right now.

[fol. 7897] By Mr. Littman:

Q. If I correctly understand your testimony, you use as the period for amortization, not the life of the gas fields or the gas supply in any given field, as such, but the reserves on hand and owned and controlled presently by the utility, is that correct?

A. Well, to make it a little more accurate, there was an investment here of some \$63,775,000 and taking the estimate that I used of 25 years, I apply it against that investment as the best judgment I had at the time, yes, sir.

That is, talking in terms of the investment as against a reserve. Reserves are included in that but what I am interested in still is what the investor has in this business and that I amortize over 25 years.

Q. You amortize the pipe line over 25 years too, do you not?

[fol. 7898] A. That is included in the investment, yes, sir.

Q. Now, assuming that the life of the field in which this company operates is something in excess of 25 years, is it your opinion that the proper amortization period to

be used for this company is the 25 years which reflects the life of the presently-owned and controlled reserves as distinguished from the life of the entire field?

A. So far as this investment is concerned with the 25-year life, I stick with the computations that I have made.

Now, if the company can go out or does go out and re-invests money in some reserves that will last 30 years, you have a new investment and I will use the 30-year period but, for the present investment, it seemed to me a conservative figure to use in view of all that had been said about the reserves in the immediate vicinity of the company's present plant and facilities.

Q: I would like to know the basis of your theory and I would like to have the record clear on this subject; Mr. Coffman, so I shall put a hypothetical case, to make it clear.

Assume that we have a company whose presently-owned and controlled reserves will last for a period of 25 years. Assume that that company operates in gas fields whose over-all life will extend over a period of 50 years.

[fol. 7899] What term of years, under your theory, would you use for the purpose of amortizing the invested capital of that company, the 25-year period or the 50-year period?

A. For that particular investment, we are talking about 25 years.

Q. I call your attention to the statement at the bottom of Page 116 of Exhibit 147, which is the Securities and Exchange Commission's opinion to which reference has heretofore been made, with respect to the recent refinancing.

"An independent geologist has estimated that the minimum life of the reserves is 25 years. It was testified that the company could, without difficulty, acquire reserves sufficient for 30 to 35 years after allowing for a greatly expanding market in Michigan."

I take it that, under your method, that statement would not affect the term of 25 years which you used?

A. No, for the reason that I have given, that the 25 applies to the present investment and a new investment would be made to get the 30 to 35 year reserves.

Q. Mr. Coffman, in your opinion, is Panhandle Eastern Pipe Line Company entitled to earn a fair return on anything other than the prudent investment in its property presently used and useful in the public service, less depreciation?

The Witness: May I have that read, please?

[fol. 7900]. (Whereupon, the pending question was read by the reporter.)

The Witness: Well, if you mean by "prudent investment", actual capital that went into the firm, I think that is the figure.

By Mr. Littman:

Q. Let me state the question in another way in order to avoid the difficulty that I see we are about to get into.

In your opinion, is Panhandle Eastern Pipe Line Company entitled to earn a fair return on anything other than the original cost of its property presently used and useful in the public service, less depreciation?

Now, when I speak of "property", of course I mean just that, physical property and intangible property used and useful in the public service.

Mr. Wheat: You mean as a rate base?

Mr. Littman: Yes, as a rate base.

The Witness: My answer, Mr. Littman, has to be based pretty much on the statement I made before.

By Mr. Littman:

Q. Can't you answer this particular question yes or no first, and then explain? I think it would be helpful for the record.

A. I do not believe I can for this reason, maybe I am wrong. If you have a situation where the original cost of the company is a certain item and that company has been [fol. 7901] acquired by another company someplace along the line for which the company actually paid for earning capacity that had been built up and cash actually changed

hands or capital does, I say that that, as distinguished from your aboriginal cost, is the cost of the company, is a part of invested capital.

I include it and that is the reason I can't answer your question directly.

I will answer your question directly if you will say that cash was put into the original property and there was no further investment; yes.

If there was any further investment by reinvestment of earnings, then that still is invested capital and I want to amortize that.

Q. Now, you understand I am now speaking of return, not amortization, Mr. Coffman?

A. Yes, I understand.

[fol. 7903] By Mr. Littman:

Q. - Assume we have a natural-gas pipe-line company such as Panhandle Eastern that owns a pipe line and certain other physical property and certain intangible property used and useful in the service of the public.

Now, what I would like to know is whether, in your opinion, and under your theory, that company is entitled to earn a fair return on anything other than the actual original cost of its property presently used and useful in the public service less depreciation.

Trial Examiner: In other words, are you asking this witness to state whether or not his views take into account other factors than are expressed in the Statute?

Mr. Littman: That is right. I would like to know whether this witness is allowing in his "dollars needed" something more than that which the Statute says the company is entitled to, in fact, much more.

By Mr. Littman:

Q. Now, are you prepared to answer this question?

A. I do not know as I can answer it any differently than I did.

[fol. 7904] If the sum total of that represents invested capital, the answer is yes, that is the figure I am using.

Q. Now, Mr. Coffman, in other words, under your theory, every dollar that the investor has invested in the business, as represented by the total outstanding common stocks, preferred stocks, surplus and bonds, is that upon which the investor is entitled to earn a return for rate-making purposes?

A. That is correct.

Q. Even though a large part of those dollars are not actually invested in property, isn't that right, devoted to public service?

A. If they are still invested capital, I use it.

Q. In other words, if a natural-gas pipe-line company has \$20,000,000 of actual property, both physical and intangible, and needs \$1,000,000 actually for working capital, \$21,000,000 in all,—I am speaking of net property when I speak of \$20,000,000,—and has \$20,000,000 of cash in the bank, you would, under your method, allow a return upon that \$20,000,000 of cash over and above the working capital?

A. So long as it is invested capital and remains in the business. Otherwise, I say that it should be distributed to the capital holders.

[fol. 7905] Q. In other words, your answer is yes?

A. That is correct with the additional statement I made.

Q. And you would also amortize the same, to-wit, the total invested capital?

A. That is correct.

Q. I would like to discuss the subject of taxes with you, Mr. Coffman. Will you please refer to your Exhibit No. 152—withdraw that.

Before discussing Exhibit No. 152, I would like to discuss another matter, namely, your Chart No. 29 of Exhibit 65 which is also related to taxes.

Now, you have estimated, as shown in Chart No. 29 of Exhibit 65, a 10-percent increase for higher wage and materials cost for the projected period beyond June 30, 1941, have you not?

A. I have projected the over-all figure by 10 percent, yes, which allows for variations in labor and material costs.

Q. The amount of the increase is \$319,000-odd, is it not?

A. That is correct.

Q. Now, each dollar of increased expenses will reduce taxable net income by \$1, will it not?

The Witness: Will you read that, please?

[fol. 7906] (Whereupon, the pending question was read by the reporter.)

The Witness: Yes, that is correct.

By Mr. Littman:

Q. And each dollar of reduced taxable income will reduce the company's liability for Federal income taxes and excess profits taxes by 72.4 cents, as you have heretofore testified?

The Witness: I must be a little tired, will you read that question, please?

(Whereupon, the pending question was read by the reporter.)

The Witness: I think that is about right, yes.

By Mr. Littman:

Q. That is, provided, of course, that that dollar falls into the top bracket?

A. In the top bracket, yes.

Q. Now, since you estimate increased expenses of \$319,000 for your projected period as shown in Chart No. 29, isn't it a fact that taxes will be reduced by 72.4 percent of that \$319,000 amount or by approximately \$230,956?

A. If the tax remained the same, it would be, if the tax rate remained the same but that was not the analysis that I made.

Q. Of course, if the tax rate goes up 10 percent in the projected period as you have shown it in Chart No. 30—

[fol. 7907] Mr. Culton: (Interposing) He did not say the tax rate would go up 10 percent.

The Witness: No, I said that I applied the 1941 rate and allowed 10 percent additional, not the tax rate.

By Mr. Littman:

Q. For an increased tax rate, didn't you?

A. No, an increase in taxes, not the tax rate.

Q. Very well, but if it is a fact that the taxes will increase an additional 10 percent in the projected period, the savings in taxes would be even greater than the \$230,956 which I have indicated, isn't that right?

A. I do not know what the amount would be but that is included in any calculation to get taxes.

Q. What is included in your calculation?

A. I have allowed for this increase in operations and maintenance so if it makes a saving, I have made this comparison with what it was before.

Q. Mr. Coffman, I would like to have you point out to us in your exhibit where you have made any allowance in your estimate of taxes for the projected period by reason of the increased expenses which you show in Chart No. 29.

A. Well, it is automatic when you rebuild the profit and loss statement and apply the new rates.

Q. Can't you show us how you took care of that? We [fol. 7908] have been unable to find it. Your table for Chart No. 23, I believe, shows your calculation, shows the amount of taxes allowed for the year ended June 30, 1941, as reported by the company and, secondly, as adjusted by you to reflect the 1941 increased tax rate.

A. I guess I do not follow you, Mr. Littman, because, if you look over to table for Chart No. 29, you see there in that column the projected figures for the new allowance in the amount of \$3,516,000 and that item was considered in the calculation to get the final result.

The only purpose that I had in the other exhibit of showing the comparison was to indicate on the same income basis that the tax rate alone made a difference of \$1,000,000 in cost to the company which was just part of my argument to show why it seemed to me to be reasonable that an increased rate should be allowed.

Q. You still have failed to show where, in your exhibit, you reduced the taxes by reason of the increased expenses that you have allowed for your projected period. Where have you done that?

Mr. Wheat: Mr. Examiner, there seems to be some calculation necessary here. Everyone is fatigued after a long day and we are approaching within two or three minutes of the time of adjournment.

[fol. 7909] I am confident we cannot finish tonight and I suggest we go over to a short session tomorrow morning.

Mr. Littman: I do not believe this requires a calculation. Does it? Of course, I appreciate your position.

Mr. Wheat: I think everybody is tired out.

Mr. Culton: Frankly, we concede he made no calculations based on the increased taxes in 1941.

Mr. Littman: If counsel will concede there is a saving coming of the figure which I named of—

Mr. Culton: (Interposing) I stated he made no calculation based on the increased cost in 1941.

Mr. Littman: And gave no credit in his exhibit.

Mr. Culton: That is all I said. That is what you asked him to show, where he gave that in the showing for increased taxes.

There has been no calculation made of increased taxes. There has been no calculation put in evidence showing the amount of taxes based on increased expenses.

Mr. Littman: You see, this witness, Mr. Culton, has a 10 percent increase in expenses.

Mr. Culton: But you keep quoting a 10-percent increase in tax rate and he never has said anything about 10-percent increase in tax rate.

Mr. Littman: Now, Mr. Culton, I gave that up a long time ago. We passed that bridge away back yonder.

[fol. 7910] Now, he allows an increase in taxes.

Mr. Culton: All right.

Mr. Littman: He allows an increase in expenses. He has given no credit in his exhibit for the increased expenses.

Now, I do not pay very much in taxes but I know when my expenses go up in a given year, my taxes go down, all other things remaining the same.

Now, he has not shown the corresponding saving in taxes.

Mr. Wheat: Are you able to answer the question now?

The Witness: The answer is the same as on some of the other detailed items, that I did not breakdown the individual items so I could say one was 10 percent, one 5, another 20 and another nothing.

I allowed for an over-all increase in taxes and that is the reason I have not been able to get your point. I admit I am a little thick this afternoon.

By Mr. Littman:

Q. We can finish this point, at least, before we quit tonight and I think this will clear it up.

You allowed for a 10-percent increase in expenses, didn't you? A. That is correct.

Q. For your projected period? A. That is correct.

[Col. 7911] Q. But you did not reduce the taxes by reason of that increased expense, did you?

A. No, and on the same theory I used in certain other cases, whereas you had that change in the one instance, there might be something that would offset it otherwise so that, on the average, a 10-percent increase over-all for taxes would be a reasonable ultimate figure.

Q. You do not pay taxes on that basis, do you, Mr. Coffman, nor does anybody else pay Federal income taxes on any such basis as that?

A. No, that is correct, but it was an over-all figure because I could not tell, as a matter of fact, what the ultimate result would be.

Q. Well, you knew what your net income was going to be, didn't you, under your theory?

A. I can calculate that, yes, I have it.

Q. But you have not done it in this Exhibit 65, have you? A. That is correct.

Q. That is, you are saying you have not done it?

A. That is correct, I have not made the calculation, that is right.

Q. Nor have you done it in Exhibit No. 152 in that way?

A. No, the purpose of 152 was for a different matter.

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[fol. 7935] GEORGE S. YOUNG, a witness, having been previously sworn, resumed the stand and testified further as follows:

Cross-Examination.

By Mr. Littman:

Q. Mr. Young, you have prepared and submitted in this proceeding an exhibit which has been designated as Exhibit No. 77, "Michigan Gas Transmission Corporation-Description of Physical Property", have you not?

A. I have.

Q. In this exhibit, you describe the lines owned by Michigan Gas Transmission Corporation, do you not?

A. I do.

Q. Mr. Young, you are the Vice President and the General Manager and a Director of Michigan Gas Transmission Corporation?

A. That is correct; until February 6 that was the case. [fol. 7936] You have resigned certain of these positions?

A. I am Vice-President only at the present time.

Q. When did you first become General Manager?

A. When I first came to Detroit, June 1, 1936, I was designated General Manager.

Q. When were you elected a Director?

A. In May, 1940, I was elected a Director.

Q. And when did you first become Vice President?

A. In December, 1936.

Q. So that you have occupied the position of Vice President and General Manager from 1936 to February of 1942?

A. Except for a brief period which I have mentioned here when I was on active duty in the Naval Service.

Q. That was in what year?

A. That was in the year 1941.

Q. How long a period were you away from your duties as Vice President and General Manager?

A. From February 1, 1941, until September 1, 1941.

Q. Would you please give us at this time a brief description of the main transmission lines of Michigan Gas Transmission Corporation?

A. As they exist at the present time?

Q. Yes and, if you wish, you may refer to your map, Exhibit No. 78.

A. The Michigan Gas Transmission Corporation main [fol. 7937] line pipe system starts at the Illinois-Indiana State line or very near the Indiana-Illinois State line and runs eastward from there for about 72 miles and is composed of a 20-inch pipe line and a 24-inch pipe line.

Q. May I interrupt to ask whether the starting point is at Dana, Indiana, and the terminal point for the line which you have just described is at Zionsville, Indiana?

A. That is correct, at a point near Zionsville.

Q. That is what is known as a loop line, is it not?

A. That is correct.

Q. Now, will you continue your description?

A. From Zionsville, a main pipe line continues in a northerly direction to Muncie, Indiana. This is an 18-inch pipe line. At the terminus of the loop pipe line which we have mentioned and which is near Zionsville, Indiana, there is a 22-inch pipe extending in a northeasterly direction about 230 miles to Detroit.

Q. What is the length of the 18-inch line running from Zionsville to Muncie?

A. That is about 52 miles, approximately 52 miles.

Q. In addition to the lines that you have mentioned, is it not a fact that Michigan Gas Transmission Corporation also owns certain lateral lines?

A. That is correct.

Q. Will you please describe those, briefly?

[fol. 7938] A. There is a 6-inch line extending from a point on the loop line to Crawfordsville. That is a 6-inch line. Do you wish me to give the length of it?

Q. Approximately.

A. I can only give the footages as I read them off here. That line is approximately 98,000 feet.

There is another lateral line, A-107, extending from the loop line to Lebanon. I read from the map that that is 69,598 feet.

From the pipe line extending from Zionsville to Detroit which is designated at this point as Line C, there is a lateral pipe line C-104 extending to Tipton, Indiana, which is 69,774 feet. Also from Line C to Fort Wayne, there is a later line designated as Line C-101, 66,104 feet. This lateral pipe line is partially looped, I believe, to the extent of about 60,000 feet. It is not indicated on this map.

Those are the principal lateral lines which belong to the Michigan Gas Transmission Corporation. There are a few very short lines tying on to measuring stations which are adjacent to the main pipe line.

Q. When did Michigan Gas Transmission Corporation begin operating these lines that you have described?

A. As of June 1, 1936, or shortly thereafter. I came to Detroit on June 1, 1936, and it was shortly thereafter we picked up the operation on them.

[fol. 7939] On June 1, 1936, we had only the pipe line extending from Dana to Muncie. Line C, the 22-inch line, had not been completed as of that date but we immediately picked up the operation of the 22-inch line when it was completed.

Q. In addition to the lines that you have just described, Michigan Gas Transmission Corporation has been operating certain other lines, has it not?

A. That is correct.

Q. Will you describe those lines?

A. One of those lines extends from Muncie in a southeasterly direction a distance of about 30 miles. It is a 16-inch line which, until February 6 of this year, belonged to the Ohio Fuel Gas Company.

Q. Now, what other lines belonging to Ohio Fuel Gas Company has Michigan Gas Transmission Corporation been operating?

A. The line which I have just described as designated on the map as Line D and from that line there is a lateral line designated D-172, a 6-inch line extending to Winchester, Indiana.

Q. That line is, in reality, a lateral line, is it not?

A. That is a lateral pipe line.

Q. Will you continue your description of the Ohio Fuel Gas lines which your company has been operating?

A. Since about October 6, when the Richmond market was connected, we have also been operating that part of the 16-inch line which extends into Ohio to a point where [fol. 7940] the line connecting Richmond takes off. We have also been operating that lateral line there which connects Richmond and prior to the time that the Richmond market was connected, we maintained that section of pipe line down to Richmond which was within the State of Indiana.

Q. What is the size of the line running from Richmond north to the junction with Line D?

A. It is indicated as being 10-inch.

Q. Now, has your company also been operating that portion of the Ohio Fuel Gas line which is not colored on this map, Exhibit No. 78, which extends into Ohio?

A. Yes, since the Richmond market was attached which, I believe, was October 6, 1941.

Q. Now, how far does that line extend into Ohio?

A. I do not have that figure.

Q. Just approximately.

A. I would say approximately 2 miles.

Q. And does any of Michigan Gas Transmission Corporation's gas pass beyond that point eastwardly?

A. No, it does not.

Q. But the line itself physically does extend further east, does it not?

A. Yes, there is a continuation of that Line D further east. It is indicated on this map as Z-50.

Q. Is there a break in that line at the point where [fol. 7941] Michigan Gas Transmission ceases to operate the line?

A. There is not. It is continuous.

Q. It is a continuous line?

A. Yes.

Q. There is a valve shutting off the flow eastward?

A. That is correct.

Q. And from that point, the gas flows due south and somewhat to the west to Richmond, Indiana?

A. That is correct. The valve that I speak of, that is, the block valve in that Line Z-50, is not exactly at the point of take-off but it is very close.

Q. How long has your company been operating this Ohio Fuel Gas Line?

A. That is, all of the Ohio Fuel Gas lines that I have described?

A. Yes.

The operation of those lines was picked up shortly after June 1, 1936. I do not remember just exactly when it was but it was shortly after that time.

Q. When were those Ohio Fuel Gas lines that your company has been operating constructed?

A. The information I have with regard to Line D is that it was constructed in 1913. As to the other two, that is, the line which is designated D-178 and the Richmond line, I have no information as to when those were constructed.

[fol. 7942] Q. Isn't the correct number D-172?

A. D-172 is the lateral I do not know about.

Mr. Baldridge: Mr. Young, did you mention the little stub of lateral that goes to Lynn?

A. I have not mentioned that, no. That is a very short lateral.

Mr. Baldridge: That comes off the line you described as being D?

The Witness: That comes off the Line D as indicated on this map.

Mr. Baldridge: These lines that you described as belonging to Ohio Fuel Gas Company were sold by Ohio Fuel Gas Company to Panhandle Eastern Pipe Line Company on February 6, were they not?

The Witness: Yes, that is correct.

By Mr. Littman:

Q. Can you state the price at which these lines which you have described were sold by Ohio Fuel Gas Company to Panhandle Eastern Pipe Line Company?

A. I have read the agreement under the terms of which these lines were sold and my recollection is that these pipe lines to which you have referred were sold for \$439,000 in round figures.

Q. \$439,326.08 is the figure to which you refer?

A. I do not remember the dollars and cents. I just remember the round figure.

[fol. 7943] Trial Examiner: Are counsel in agreement that that is the figure?

Mr. Culton: Yes, sir. That appears in the S. E. C. statement, Exhibit 147, I believe.

Mr. Littman: The figure which I read was taken from the Securities and Exchange Commission's opinion which is in evidence as Exhibit 147.

By Mr. Littman:

Q. Under what arrangement has Michigan Gas been operating these Ohio Fuel Gas lines which you have described?

A. There has been no written contract covering their operation. The Michigan Gas Transmission Corporation has operated the pipe lines and received the revenue from the sale of gas sold from these pipe lines, but it has not paid the Ohio Fuel Gas Company anything during the period that I speak of for the use of these lines.

Q. No rental was paid?

A. No rental was paid.

Q. For the use of the line?

A. That is correct.

Q. The Ohio Fuel Gas Company is a wholly-owned subsidiary of Columbia Gas & Electric Corporation, is it not?

A. I believe it is. I am not sure of that. It is a Columbia subsidiary. I do not know whether it is wholly-owned or not.

[fol. 7944] Q. Who bore the expenses of maintenance and operation of these Ohio Fuel Gas lines?

A. The Michigan Gas Transmission Corporation.

Q. So that your operating statements in the past few years, at least since 1936, reflect the operations and maintenance costs of those lines, do they not?

A. That is correct.

Q. What of the depreciation expense and cost of replacements? Who has borne that?

A. I am not sure about that, Mr. Littman. I think the Ohio Fuel Gas Company has borne that.

Q. Will you please try to ascertain that for us and report back?

A. I shall.

Q. Did Ohio Fuel Gas Company either directly or indirectly derive any revenue from these lines which you have described during the period 1936 to date?

A. Not to my knowledge, no.

Q. That is, that situation obtained during the time that you operated the lines?

A. That is correct.

Q. What cities are now served by these Ohio Fuel Gas lines?

Mr. Baldridge: May I inject something there. You mean by "these lines", all of the Ohio Fuel Gas lines?

[Feb. 7, 1945]. Mr. Littman: Yes. I have been describing them as the Ohio Fuel Gas lines. I think the record now shows they have been sold to Panhandle Eastern Pipe Line Company.

The Witness: Michigan Gas Transmission Corporation has sold gas to Indiana-Ohio Public Service Company, which distributes gas in the Towns of Winchester, Portland and Union City. It also has sold gas to Lynn Natural Gas Company and, since October 6, 1941, it has delivered gas to Richmond for the account of Panhandle Eastern Pipe Line Company.

In addition to that, there has been a sale made to the Indiana Gas Distribution Corporation for ultimate resale to the Anchor-Hocking Glass Company which is located near Winchester, Indiana.

By Mr. Littman:

Q. What do you have to say with respect to the physical condition of these lines formerly owned by Ohio Fuel Gas Company?

A. I would say that the condition of the lines is only fair.

Q. What causes you to make that statement and what facts lead you to that conclusion?

A. The leakage which we have been able to determine from that line and the amount of maintenance work which we have had to do on the line. I am speaking particularly of Line D. Line D-172 has not required a great deal of maintenance.

Mr. Littman: Will you please read that answer back?

[fol. 7946] (Whereupon, the last answer was read by the reporter.)

By Mr. Littman:

Q. What has been the recent experience of the company with respect to leakage on Line D which is the 16-inch line extending from Muncie to a point a little beyond the Ohio-Indiana State line?

A. I do not have those figures here, Mr. Littman. I could produce them.

Q. But you do know that the leakage is abnormally high?

A. That is correct.

Q. Will you please secure the leakage figures on that line?

A. I will.

Q. And report back later?

A. All right.

Q. What has been the extent of the leakage on the line running north from Line D, namely, the Line D-172 running to Winchester, Indiana?

A. The leakage on that system east of Muncie has been determined as a whole. That is, we have taken the sum of the measurements of gas taken from that line and subtracted it from the delivery of gas into that pipe line so that the leakage figures which I will present reflect the leakage from the entire system.

Q. You are referring to points east of King measuring [fol. 7947] station?

A. East of King measuring station.

Q. Which is to the east of Muncie?

A. That is right, and the figures that I would present, at least for the years 1940 and prior thereto would only cover down to the State line.

Q. What has been the maintenance experience of Michigan Gas Transmission Corporation in operating Line D extending from Muncie to the Ohio-Indiana Line and slightly beyond it east?

A. We have had a considerable amount of maintenance on that pipe line. By that I mean that we have had to repair a considerable number of leaks on the pipe line and recondition the couplings between that pipe line.

Q. What type of couplings are on this line?

A. Well, they are the Dresser type of couplings. I do not know whether these were manufactured by Dresser or by another manufacturer, but they are the Dresser type.

Q. Are you prepared to state the maintenance figures for the years during which Michigan Gas has operated Line D?

A. I am not sure about that. I cannot at this moment. I am not sure whether they can be segregated or not.

Q. Will you please ascertain that fact and, also, see if you can get us the maintenance figures for the lateral line extending north to Winchester?

A. Yes.

[fol. 7948] Q. Can you give us a description of Line D in the same detail as that which you have given for Michigan Gas Transmission lines in Exhibit 77?

A. Do you mean as to length, Mr. Littman?

Q. I mean particularly as to the type of pipe and the type of couplings, river crossings, the same information which you have with respect to the other lines in Exhibit 77.

A. The 16-inch line is a coupled line and, as far as I know, the points at which lengths of pipe are coupled, I do not believe that double random lengths or 40-foot lengths of pipe were available at the time that pipe line was constructed.

Q. This is steel pipe?

A. It is steel pipe.

Q. Are there any river crossings?

A. There are no multiple river crossings, there are some stream crossings there but no multiple river crossings.

Q. What is the wall thickness of the pipe?

A. I do not know.

Q. Has your company ever made any pipe inspections on that line? By that I mean have they dug any holes along the line and made reports?

A. No, they have not. Of course, they have dug a great many holes to make inspections and have noted the conditions, not to make inspections but to make repairs at points where leakage was indicated, and they reported the conditions found when they dug down but we have not made any investigation of this pipe line.

Q. Are the reports that were made at the time each of these repairs was installed with respect to the condition of the pipe line filed and are they on file at your offices here in Detroit?

A. They are. They report the repair work undertaken on the line, I do not believe they express any information as to the condition of the pipeline or anything like that.

Q. Have you personally ever observed any of the pipe on this line?

A. I have not. Well, I have observed it where it has been exposed where it passes through creek beds, but I have not observed any of the buried pipe.

Q. Has Michigan Gas Transmission Corporation followed the practice of making routine pipe inspections on its lines?

A. Oh, it has not made routine pipe inspections but several pipe inspections were made prior to the time that the inspection was made which was presented in connection with this rate proceeding.

Q. You were referring to Mr. Riddle's inspections when you referred to those that were made for the purposes of this proceeding?

A. That is correct.

Q. Will you tell us something about the prior inspections, [fol. 7950], who made them and how often were they made?

A. I cannot give you much detailed information. Copies of those were referred to your engineer, Mr. Bodner. I think there were either three or four of them.

Q. What do you mean by three or four of them?

A. Three or four reports.

Q. Reports?

A. Made at different times.

Q. Do they cover a number of different inspections?

A. They cover a number of different inspections.

Q. Has it been the practice of Michigan Gas to have reports made as to the condition of pipe when pipe is uncovered during the course of repair or other work?

A. If conditions were found when the pipe was uncovered that were not entirely satisfactory, it has been a matter for discussion, but I do not recall that any formal reports have been made covering that.

Q. You mean you have nothing in writing with respect to the condition of the pipe observed at these points when uncovered for purposes of repair or other work?

A. No, not that I can recall.

Q. Can you state how many leaks which were caused by corrosion have been repaired on the main transmission lines of Michigan Gas Transmission Corporation system since you came with that company in 1936? I am excluding the lines formerly owned by Ohio Fuel Gas Company from [fol. 7951] my question.

A. You are referring now to leaks through pitting in the pipe?

Q. Caused by corrosion.

A. I cannot recall any at this moment.

Q. Let us take the past year, do you recall any in the past year?

A. Well, I would say within the last few days, I have had a report with regard to one leak due to corrosion in Line A, I believe it is designated on this map. That is the 20-inch line.

Q. That is the line running from Dana to Zionsville?

A. That is correct, and it is the 20-inch part of that loop.

Q. Where was that leak discovered in the line?

A. I cannot tie that down very definitely, Mr. Littman. It was some place on the 20-inch line.

Mr. Littman: Will you please read the answer?

(Whereupon, the last answer was read by the reporter.)

By Mr. Littman:

Q. Will you ascertain the point and report that information to us during the course of this hearing?

Mr. Culton: Mr. Young, that is the old portion of the line?

The Witness: That is the 20-inch portion of the loop, the other portion of the loop is 24-inch.

By Mr. Littman:

[fol. 7952] Q. And that latter line, which you have just described, on which the leak occurred was installed in what year?

A. In 1931.

Q. Now, do you know of any other leaks which have been discovered on your main transmission line, since 1936?

A. I know of no others resulting from corrosion. There have been other leaks in couplings.

Q. What caused those?

A. Well, the rubbers in the couplings leaked or the center ring in the coupling failed.

Q. What do you mean when you say, "the center ring failed"?

A. The center ring is welded. It is a ring seven inches wide which is welded and, in some cases, there have been failures of that which have permitted leakage.

Q. That is mechanical failure?

A. That is correct.

Q. Has any pipe been replaced in the main transmission line of Michigan Gas Transmission Corporation since they were first installed for any reason?

A. Yes, at the time the breaks occurred in the pipe line in January 1937, some of the pipe which was blown out of the ground at that—

Q. (Interposing) I believe you have described that in your Exhibit 77.

A. I do not know that I have stated there that any pipe [fol. 7953] was replaced. I have described the breaks.

Q. How many lengths of pipe were replaced by reason of those breaks which are described in Exhibit 77, Pages 15 to 17?

A. Well, I believe that about four or five lengths were replaced. I am not sure of that.

Q. Now, does that constitute all of the replacements of pipe in the main transmission system of Michigan Gas since the lines were originally installed?

A. To the best of my knowledge that constitutes all of the replacements since 1936. There may have been replacements in pipe line extending from Dana to Muncie prior to that time and I would not know about that.

Q. Michigan Gas Transmission Corporation did not own these lines prior to 1936, of course?

A. No, that is correct.

Q. Do you have an opinion as to the probable life of the main transmission lines which were installed in 1930?

A. No, I have not.

Q. Do you have any opinion as to the probable life of the main transmission lines which were installed in 1936?

A. I have not. I have not given any thought to that subject.

Q. You are an engineer, are you not?

A. I am an engineer, yes.

Q. Do you know what amount has been accumulated in [fol. 7954] the depreciation reserves of Michigan Gas Transmission Corporation at the end of 1941?

A. I do not know exactly, Mr. Littman. I believe, from an examination of financial statements, in the neighborhood of \$2,000,000.

Q. Do you have copies of the 1941 financial statement?

A. No, I do not have that with me.

Q. Does anyone here have a copy of it?

A. I will get one.

(A document was handed the witness.)

The Witness: On page 2 of the financial statement for the period ended December 31, 1941, it is indicated that the reserves as of December 31, 1941, were \$2,212,098.76.

By Mr. Littman:

Q. Now, will you please state how much of that represents the reserves for depreciation?

A. Well, I am not a accountant, Mr. Littman, and I do not know that I can clear that matter up. I am reading from Page 2-A of the financial statement for the period ended December 31, 1941, and it states that the reserves for retirement and depletion as of that date were \$1,697,894.03.

Q. In your opinion as the manager of the property of the Michigan Gas Transmission Corporation, is this reserve an adequate, reasonable and proper reserve for the depreciation and amortization which has accrued on this [fol. 7955] property to December 31, 1941?

A. The reserve that has been accrued for amortization and depreciation of the property was based on an estimated life of the field, that is the field which supplies these pipe lines and I am not in a position to say at this moment whether that is adequate or not. That is something that was not within my province to determine.

Q. Well now, what was the life of the gas field upon which the depreciation rates that went to make up this reserve were charged in the past?

A. Well, as of 1936 when we started to charge 3 percent for this account, it was estimated that the life of that field was about 33 years. That figure was given to me at that time and on that basis we proceeded to charge 3 percent.

Q. And you think that on that basis, on that assumption, the reserve is adequate?

A. Well, if the life of the field is, as it has been reported, reasonable, I believe I could say that it was adequate as a figure to cover amortization on a straight line basis, but whether it is adequate to cover other things, I am not sure at this time.

Q. What part, if any, did you have to play in the determination of the depreciation rates which have been applied in the past years for depreciation and amortization?

A. None whatever.

[fol. 7956] Q. You did not have anything to do with it?

A. No, I was simply told what to do.

Q. Who told you what to do in that regard?

A. The management of the Michigan Gas Transmission Corporation which is located in New York.

Q. And what was the name of the individual who told you?

Mr. Beckjord, who was President of the Michigan Gas Transmission Corporation.

Q. Now, the rates that have been charged in the past for depreciation and amortization are shown in Exhibit 99, Page 3, are they not?

A. I am not familiar with the details of this statement, Mr. Littman. It was prepared by Mr. Spitznagle.

Q. Well, the heading of Page 3 reads "Depreciation Provisions Per Books for the Years Ended December 31, 1936, to 1940, Inclusive, and Six Months Ended June 30, 1941."

Don't you recognize these depreciation rates as the rates which are shown on the books of your company?

A. I do not recognize them as such, but I presume that they agree, however, that is, I do not have the figures that were actually charged to this account in my mind.

Q. You mentioned something about a 33-year life of the gas supply. You see, do you not, the rate of 3 percent on Line 4 which has been applied to most of the property of Michigan Gas Transmission Corporation? Do you recognize that?

[fol. 7957] A. Is that on Page 1, Exhibit 99?

Q. Page 3.

A. Excuse me. Yes, I see that.

Q. To the best of your knowledge, Mr. Young, as the operating manager of this property, would you state that the depreciation rates which have been applied by this company since 1936 have been adequate, reasonable and proper and are adequate, reasonable and proper for the purpose of providing annual allowances for depreciation and amortization?

[fol. 7959] The Witness: Well, I do not know anything about the theory of accounting, understand that, Mr. Littman, but I would say that if the life of this field which has been reported or was reported as of the date that we started to charge 3 percent is correct, that, in my opinion and again understand I am not an expert in these matters—that would probably be adequate.

By Mr. Littman:

Q. And reasonable?

A. Yes, and reasonable.

The Witness: Mr. Littman, I failed to mention some other pipe lines which are owned by other companies and operated by the Michigan Gas Transmission Corporation. One is a pipe line belonging to Public Service Company of Indiana extending from Crawfordsville to Lafayette.

By Mr. Littman:

Q. What is the distance of that line?

[fol. 7960] A. It is not indicated here but my recollection is that that is about 23 miles.

Q. That is not colored-on map, Exhibit 78, is it?

A. No, it is indicated as a dotted line on Exhibit 78.

Q. How long has Michigan Gas Transmission Corporation been operating that line?

A. Since 1937, I believe, since the date the contract was made with the Public Service Company.

Q. Will you describe, generally, the arrangements under which that line is operated?

A. It is a contractual arrangement.

Mr. Baldridge: Isn't that set forth in a contract filed with the Commission?

The Witness: That is right. It is part of the contract covering the sale to this company.

Shall I proceed?

By Mr. Littman:

Q. Yes.

A. And in addition, the line extending from the one just described to Attica which also belongs to the Public Service Company of Indiana and is a 4-inch line.

Q. Now, is the contract under which that line is operated by Michigan Gas also on file with the Federal Power Commission? A. Yes, it is.

Q. What other lines did you want to describe? [tel. 7961] A. The line belonging to the Toledo-Edison Company supplying Defiance.

Q. Defiance, Ohio?

A. Defiance, Ohio. My recollection is that about 5 miles of 3-inch pipe line owned by the Toledo-Edison Company is operated under the terms of the lease agreement by the Michigan Gas Transmission Corporation.

Q. Is that agreement on file?

A. I do not know, Mr. Littman.

Mr. Littman: Do you know, Mr. Baldridge?

Mr. Baldridge: Which agreement was that?

Mr. Littman: The agreement with reference to the Defiance line, the lateral line.

Mr. Baldridge: I know the agreement for the sale of gas to Toledo-Edison is on file. Whether the agreement for the maintenance of the line is on file, I rather doubt, because it did not appear to be—as I recall it and I am speaking from recollection now and I may be wrong—it did not appear to be anything that affected the rates and may not be on file.

By Mr. Littman:

Q. Can you state, Mr. Young, whether Michigan Gas bears all of the operation and maintenance expenses of these lines which you have just described?

A. It bears the operating and maintenance expense but does not bear the tax cost.

[fol. 7962] Q. Are you speaking now of the ad valorem taxes?

A. I am speaking of all taxes.

Q. Federal, as well as State and local?

A. All taxes, I would say. We pay no taxes on those properties. Of course, we will pay an income tax to the extent that we profit from the sale to the customers served by those lines.

Q. That is, you pay the Federal income tax and excess profits tax on the revenue derived from these lines as well as other lines? A. That is right.

Q. But all other taxes are borne by the companies that own these lines in fee?

A. Of course, the people who are engaged in operating these lines are our employees and we have to pay certain taxes on those people, Social Security taxes and things of that sort, but we do not pay any property taxes.

Mr. Baldridge: May I interrupt to say that the contract with the Public Service Company of Indiana which has been referred to and under which the seller, that is, Michigan Gas Transmission Corporation, agrees to operate a certain line or lines as Rate Schedule No. 17.

Trial Examiner: When was that filed, Mr. Baldridge? It was filed with the Federal Power Commission on what date?

Mr. Baldridge: It was filed with the Federal Power [fol. 7963] Commission, I think about September 1, 1938, at the time when all the contracts were required to be filed. There have been one or two supplements to that contract but those do not affect the lines in question, as I recall. Those lateral lines were provided for in the original contract which is dated October 1, 1936, and, as I say, was filed, I think, around September 1, 1938.

I am not sure just exactly about the date but it was at the time when the companies' contracts were filed or rate

schedules were filed pursuant to Order No. 53 of the Federal Power Commission.

By Mr. Littman:

Q. What company bears the depreciation cost for these lines, that is, which company carries the depreciation reserve? A. The company owning the pipe lines.

Q. That is not Michigan Gas Transmission Corporation?

A. They are not a part of our property account.

Q. Does that complete your description of the lines?

A. Yes, sir.

Mr. Baldridge: May I inject another question, Mr. Littman. I do not like to interrupt but I think we may get along faster. None of these lines operated by Michigan Gas Transmission Corporation belonging to other companies are carried in any way in the Michigan Gas Transmission Corporation's plant account, are they?

[fol. 7964] The Witness: No.

By Mr. Littman:

Q. Mr. Young, are you generally familiar with the major sources of natural gas in the United States within, let us say, a radius of a thousand miles of Dana, Indiana?

A. Only in a very general way. I have not had any reason to investigate them personally. I have read about them, that is all.

Q. You know, generally, where the major sources of supply are located? A. Yes, I do.

Q. Will you name the major sources of natural gas supply in the United States west and south of Dana, Indiana, which are within approximately a thousand miles of Dana?

Here is a map of the United States which may help you.

(The map indicated was handed the witness.)

A. The major sources that I know about are in the Hugoton Field and the Texas Panhandle fields which are, so far as I know, the major sources. Then I believe that the Gulf Coast area is a major source of supply which, I think, is within a thousand miles of Dana and west.

Q. You are referring to the southeastern part of Texas, are you not? A. That is correct.

Q. And the southern part of Louisiana?

[fol. 7965] A. That is correct.

Q. There is a very extensive gas field down there, isn't there?

A. I understand that there is, yes.

Q. Where is the Monroe Gas Field located?

A. I understand that that is in northern Louisiana.

Q. Mr. Culton: Do you know if that is the field that Southern Natural is having to abandon and get gas somewhere else?

The Witness: I do not know, Mr. Culton.

Mr. Culton: There was some testimony about that a few days ago.

The Witness: I only know it by name. I do not know the condition of it.

By Mr. Littman:

Q. I will not ask you, Mr. Young, to confine yourself to 1,000 miles. You might go out 1,500 miles if required to embrace some of the larger fields of the country.

There is another large field in Texas, is there not?

A. There is the Texas Panhandle, West Texas, which I have mentioned.

Q. Where is the Waskom Field located?

A. I do not know.

Q. Dana, Indiana, is a point close to the Indiana-Illinois State line at which point your lines join those of Panhandle Eastern, isn't that correct?

[fol. 7966] A. That is correct.

Q. And isn't it a fact that the lines of Michigan Gas Transmission Corporation could be used to transport gas from these Gulf fields which you described and from the Louisiana gas field?

A. Physically, yes, if the gas was piped to Michigan Gas Transmission Corporation from the Gulf Coast area, our pipe line could deliver that gas provided they are not prevented from doing so by reason of contracts in existence.

Q. Will you please turn to Exhibit No. 79, Mr. Young.

Before passing to Exhibit No. 79, Mr. Young, I would like to ask you this: If and when the Panhandle Field

of Texas and the Hugoton Field of Kansas and Oklahoma are exhausted, isn't it a fact that the Michigan Gas Transmission lines could be used, in all probability, to carry natural gas from the Gulf gas fields and the Louisiana gas fields, assuming that that could be done economically, isn't that correct?

A. Physically, I would say that the lines would be available to transport gas if they are in condition to do so.

Mr. Baldridge: I did not hear that. Will you read the answer?

(Whereupon, the last answer was read by the reporter.)

By Mr. Littman:

Q. That is to say, the Michigan Gas Transmission lines are in a direct route between markets presently served, [fol. 7967] such as Detroit, by your lines and these fields that you have mentioned, isn't that correct?

A. The Gulf Coast fields are to the southwest of Dana and they are more or less on the route of a pipe line which might be built from that source.

Q. You are familiar, are you not, with the fact that the Hope Natural Gas Company proposes to build a line extending from the Louisiana gas fields northward into the Appalachian district, particularly into the State of West Virginia?

A. I have no first-hand knowledge of that. I read about it in the trade papers and that is the extent of my knowledge with regard to it.

Q. Let's look at your Exhibit No. 79, sir.

A. All right, sir.

Q. This exhibit is entitled, "Comparison of Daily Provided Capacity to Deliver Firm Gas with Maximum Daily Delivery of Firm Gas from System of Michigan Gas Transmission Corporation".

Were all of the pipe lines of Michigan Gas which are shown on your map, Exhibit No. 78, in service on March 18, 1941, the date of the highest demand in the winter of 1940-41?

A. I was not on the job at that time, Mr. Littman, but I understand that they were.

Q. If your impression is erroneous, you will correct the record in that regard, will you not? A. I shall.

[fol. 7968] Q. What was the total horsepower of the main compressor engines at each of the three compressor stations operated by Michigan Gas on March 18, 1941?

A. At Montezuma compressing station—7800 horsepower; at Zionsville compressing station—6500 horsepower, and at Edgerton compressing station—3900 horsepower.

Q. What additional pipe lines and horsepower have been added since March 18, 1941?

A. The partial looping of the Fort Wayne lateral has been carried out and two additional 1300 horsepower gas engine compressing units have been installed at Edgerton compressing station.

Q. What is the "provided daily capacity to deliver firm gas in M.c.f.," as that phrase is used in your Exhibit 79, for the winter period 1941-1942?

I have in mind that you should supply for me a column in the same detail as shown in Column K in your Exhibit 79.

A. I shall do that.

Q. You can do it now?

A. I can tell you in a general way the additions.

Q. Can you give me the total?

A. The additional markets which have been added are Richmond and Greenfield, Indiana, which would only increase the amount shown there under Column K, that is, the total shown under Column K by 1,500,000 or 2,000,000 per day.

[fol. 7969] Q. You are now speaking of a million or a million and a half cubic feet? A. That is correct.

Q. That is in addition to the 159,850 M.c.f. figure which appears as the total at the foot of Column K?

A. That is correct.

Q. Will you now please supply the information that I have requested, in the same detail as shown in Column K, for the winter 1941-1942? A. I will.

Q. What has been the "maximum daily delivery of firm gas in M.c.f." to date during the present winter of 1941-1942?

A. The maximum delivery of firm gas for the period that you have mentioned—excuse me, Mr. Littman, I cannot give you that figure at this time: I have here a figure of the total gas delivered by our system, that is, by the Michigan Gas Transmission Corporation system during the cold period, January 6, 7 and 8, but I do not have the daily measurement of certain interruptible customers for those days to subtract from these so that I can give you delivery of firm gas on those days.

Q. Will you please supply that information in the same detail as is shown in your Column L of Exhibit 79 for the maximum daily delivery of firm gas in M.e.f.?

A. I will.

Q. Mr. Young, I would also like to have you supply [fol. 7970] along with this latter information the total deliveries of gas on that date of maximum demand in the winter 1941-1942 thus far.

A. That would be the total including interruptible gas?

Q. Yes.

A. I can give it to you now.

Q. Very well.

A. For January 6, 1942, the total delivered, including the company use, was 176,347 M.e.f.; January 7, 178,937 M.e.f.; January 8, 177,447 M.e.f. All of the figures which I have given you include the requirements for company use.

Mr. Culton: That also includes certain interruptible customers, as I understand.

The Witness: That includes all of the interruptible customers who are being served at that time.

By Mr. Littman:

Q. And were not interrupted at that time?

A. Some were interrupted, not interrupted, to curtail.

Q. But you did interrupt some customers on January 6, 7 and 8, 1942?

A. There was some curtailment.

[fol. 7971] Q. Mr. Young, has Michigan Gas Transmission Corporation prepared an operating budget for the year 1942?

A. Yes, the Michigan Gas Transmission Corporation did prepare an operating budget for the calendar year 1942 in the month of December, 1941.

Q. Where is that budget located?

A. It is in the Michigan Gas Transmission Corporation's office.

Q. Here in Detroit?

[fol. 7972] A. That is correct.

Q. What is the form of that budget? Is it a bulky document? Perhaps you had better describe it.

A. I would say it is quite a bulky document, probably 40 pages of certain forms taken from the financial statement which show the estimated net income and net operating income for the year 1942. It also contains statistical data as to estimated sales and statistical data as to taxes and so forth.

Q. And revenues and so forth? A. That is correct.

Q. What part did you play in the preparation of that budget?

A. The budget was prepared under my supervision by several people, several persons employed by the Michigan Gas Transmission Corporation.

Q. And it represents the best judgment of yourself and the management with respect to the revenues and expenses and other items shown therein for the year 1942, does it not? A. That is correct.

Q. Will you produce a copy of that budget for our examination today?

Mr. Baldridge: May I ask a question there, Mr. Littman?

Mr. Young, has this budget been approved by the Board of Directors?

The Witness: No, it has not been. It is submitted as a [fol. 7973] routine matter by us.

Mr. Baldridge: So that it has not yet been adopted by the Corporation as such, either by the former Board of Directors or the new Board?

The Witness: Of course, it was submitted to New York.

Mr. Baldridge: You did not answer the question, it has not been approved either by the former Board of Directors or by the new Board?

The Witness: Not to my knowledge.

By Mr. Littman:

Q. Has it been submitted to either the new Board or the old Board of Directors directly?

A. Not to my knowledge.

Q. Has it been submitted to the management?

A. The routine in connection with submitting those operating budgets is to submit them to the accounting department or the Columbia Gas and Electric Corporation in New York.

Q. That has been done?

A. That has been done.

Mr. Baldridge: Don't you mean Columbia Engineering Corporation?

The Witness: I do.

By Mr. Littman:

Q. Suppose you tell us to whom this budget has been submitted.

[fol. 7974] A. I do not know, I do not believe I can name the person at the present time. It is one of the treasurers in the Columbia Engineering Corporation. There are several of them over there and I cannot name the specific one at this time to whom it was submitted.

Q. And it is a routine matter to submit the budget for each year to the Columbia Engineering Corporation?

A. To a person employed by the Columbia Engineering Corporation.

Q. And that is the company, namely, the Columbia Engineering Corporation, which passes upon the budget on behalf of the management, to-wit, on behalf of Columbia Gas & Electric Corporation?

A. I do not know exactly what use they make of it after they receive it, Mr. Littman. I presume they use it for the purpose of making forecasts, but exactly what use they make of it I do not know.

Q. Is it routine for the Board of Directors of Michigan Gas Transmission Corporation to approve these budgets each year?

A. I do not know whether it is routine or not. At no time while I was a Director of this company was an operating budget submitted to the Board of Directors for approval.

Q. So the fact that the Board of Directors of Michigan Gas Transmission Corporation has not approved this budget is not any different than the situation that has obtained in the past years?

A. Well, I was lately made a member of the Board of Directors. Now, it might have been the intention to submit that for the approval of the Board of Directors at a later date, I do not know that.

Q. And it might not?

A. It might not. I do not know what the procedure is.

Q. And the Michigan Gas Transmission Corporation has been operating under and in accordance with the 1942 budget since January 1, 1942, has it not?

A. Well, I would say yes, up until the time of the transfer.

Mr. Baldridge: Mr. Littman, may I interrupt with a question there? I do not like to keep interrupting, but I think we make better progress in this way.

Mr. Young, when was the budget sent to Columbia Engineering Corporation?

The Witness: I think that the date of it is early December and just when it was sent I do not know.

Mr. Baldridge: Of course, the functions of Columbia Engineering Corporation as to matters of Michigan Gas Transmission Corporation would be terminated as of February 6?

The Witness: Yes.

Mr. Baldridge: Except for a few odds and ends necessary in order to provide a smooth transfer from one management to another?

[fol. 7976] The Witness: As I understand it, there will be adjustments made as of a certain date.

By Mr. Littman:

Q. You cannot tell us what they are, can you?

A. No, I cannot. I think they are adjustments which will result from things that might be done between now and the date set to make that final adjustment, such as bills for services incurred prior to February 6 and things like that which have been paid subsequent to February 6.

[fol. 7984] By Mr. Littman:

Q. Mr. Young, in your testimony this morning, you referred to a company called Columbia Engineering Corporation, did you not? A. That is correct.

Q. Does that corporation render services to Michigan Gas?

[fol. 7985] A. It does.

Q. What is the nature of those services?

A. It did render services prior to February 6. The nature of the services was largely auditing, tax, engineering service.

Q. Has that company been rendering management services to Michigan Gas Transmission Corporation?

A. There is a contract, or there was a contract, rather, between Columbia Engineering and Michigan Gas Transmission Corporation, and if I recall correctly, the services of certain people in New York who rendered management service to the Michigan Gas Transmission Corporation were billed at cost.

Q. In other words, it has rendered management services to Michigan Gas Transmission Corporation?

A. Only in the person of Mr. Beckjord, I believe.

Q. What position does Mr. Beckjord occupy in Columbia Engineering Corporation?

A. He is President.

Q. That corporation is what is known as a mutual service company, is it not?

A. I am not familiar with the designation.

Mr. Bakbridge: I object to that, Mr. Littman, because that is asking for a very technical designation. It is a service corporation—

Mr. Chamberlain: (Interposing) Isn't that the legal [fol. 7986] terminology for it?

Mr. Baldridge: No, I think not, because the service company's stock is held by Columbia Gas and Electric Corporation and the service contracts and the revival of Columbia Engineering Corporation were approved by the Securities and Exchange Commission.

It is a service corporation as that term is generally used but I do not think it is fair to say it is a mutual service company because the stock is all held by the holding company in this particular case.

Mr. Littman: Does it render management services to Michigan at cost?

Mr. Baldridge: It does.

Mr. Littman: Is that your understanding, Mr. Young?

The Witness: Yes, that is my understanding.

By Mr. Littman:

Q. Will you please turn to Exhibit No. 95, entitled, "Estimated Cost of Completing Work in Progress at June 30, 1941, and Estimated Gross Income to be Derived from the Completed Projects".

In this exhibit, you have listed a number of projects that were in the process of construction as of June 30, 1941, have you not? A. That is correct.

Q. Will you state how much of this construction was [fol. 7987] completed as of December 31, 1941, or perhaps you might state what remains uncompleted as of that date.

A. I can give you the figures, Mr. Littman, that is, the total estimated project expenditure and then the amount expended during 1941. Will that be adequate.

Q. Very well.

A. The first item, routine minor additions to transmission system property as of December 31, 1941,—\$17,086 had been expended.

On the next item, routine minor additions to general property—\$6,169 had been expended.

On the next item, expenditures applicable to 24-inch loop line construction in 1940, recorded on the books in 1941,—\$74,063;

The next item, expenditures applicable to construction of Edgerton compressor station in 1940, recorded on the books in 1941,—\$24,866 were expended;

Construction of central warehouse near Bluffton, Indiana—\$26,438 were expended;

The next item, construction of measuring and regulating stations near Monroe, Michigan,—\$6,065 were expended.

Q. Apparently you expended more than you had estimated?

A. In some cases, we overran our budget, that is correct.

Q. This is one of those instances?

A. That is correct.

[fol. 7988] The next item, construction of measuring and regulating station near Elwood, Indiana—\$4,818;

The last item; installation of two additional units at Edgerton compressor station—\$302,102.

I have a total here which I have not personally checked myself, of \$461,607.

Q. Can you advise us which of these projects had been completed at December 31, 1941? The reason I ask is because some of these figures which you have given exceed the total estimated project expenditures shown in Column B of Exhibit 95 and others are slightly under the amounts shown in that column. In other words, we could not tell from the figures which you have just read into the record whether the particular project was completed:

A. All of the projects have been completed except the last one, installation of two additional units at Edgerton compressor station.

Q. You have expended \$302,102 for that, have you not?

A. That is correct.

Q. Down to December 31, 1941?

A. That is correct.

Q. Now, how much of that project remains to be completed?

A. I do not have the exact figure, Mr. Littman, but possibly \$30,000 remains to be paid to the contractor to complete that project.

[fol. 7989]. Q. Has the contractor completed the project to date?

A. Except for some minor items, yes.

Q. But \$30,000 of the total cost of this project called "Installation of two additional units at Edgerton compressor station", was not recorded on the books of Michigan Gas as of December 31, 1941?

A. That is my understanding, yes. That is an approximate figure.

Q. Now, we may conclude from your testimony that with that single exception, all of the projects set forth in Exhibit 95 have been completed and the amounts which you have read into the record are now recorded in the capital accounts of the company and were so recorded at December 31, 1941?

A. That is my understanding, yes, sir.

Q. Will you please turn to Exhibit No. 96 entitled, "Estimated Costs of Rate Case Proceedings before Federal Power Commission."

Now, this exhibit shows that at the time it was presented, you estimated the cost of the rate case proceedings before the Federal Power Commission to be \$57,900, is that correct?

A. That is correct.

Q. Are you now in a position to state how much of this amount has been actually paid?

A. No; I am not at this moment, Mr. Littman.

Q. Will you please ascertain for me the amount of these rate case expenses that have been paid by Michigan [fol. 7990] Gas to December 31, 1941, and is recorded on the books of the company? A. I shall.

[fol. 7991] Q. Mr. Young, is it a fact that Michigan Gas Transmission Corporation paid dividends on its common stock of \$649,600 in the year 1941 which amounts to 29 percent of the book value of that common stock?

A. I do not know that that is the correct figure. I know [fol. 7992] that dividends were paid but I do not know what the correct figure is.

Q. Does that sound about right to you?

A. \$629,000, you say?

Q. \$649,600.

A. \$649,000—subject to checking the record with regard to one particular dividend that was paid, that sounds approximately correct. There was a dividend paid then that was under circumstances which I am not entirely familiar with at the present time.

Q. Is it a fact that Michigan Gas Transmission Corporation has \$2,240,000 of common stock outstanding?

A. That is correct.

Mr. Wheat: You mean par value?

Mr. Littmann: Stated value.

The Witness: Of stated value, yes.

By Mr. Littmann:

Q. And that has remained constant from 1936 down to date? A. That is correct.

Q. That is the paid-in value, is it not, \$2,240,000?

A. I believe that is, yes.

Q. The dividend of \$649,600, of course, represents 29 percent of that paid-in value?

A. That sounds approximately right, if my mental arithmetic is correct.

[fol. 7993] Q. Isn't it a fact that Michigan Gas Transmission Corporation has, since the year when it began to operate its transmission lines down to date, paid the sum of \$1,993,600 in dividends or 89 per cent of paid-in value of its common stock?

A. I do not know whether that is correct or not.

Q. I presume Mr. Spitznagle, the accounting witness, will be more familiar with those facts?

A. Yes, I believe that he would.

Q. They do not sound far off to you, do they?

A. The latter one covers four or five years and I cannot give you an answer to that without checking it.

Q. I might state that that is what our investigation of the books shows. We shall interrogate Mr. Spitznagle further on that subject.

Mr. Young, you also testified on direct examination with respect to an allowance annually to be made in rates in the amount of \$38,000 for what you have termed "extraordinary or abnormal maintenance", did you not?

A. That is correct.

Q. You did not submit an exhibit on that subject, did you? A. I did not.

Q. Is my understanding correct that \$30,000 of this amount is for pipe line maintenance, \$6,000 is for extraordinary or abnormal maintenance of compressor stations and \$2,000 is for renewals in measuring and regulating stations and on field equipment? Is that right?

[fol. 7994] A. That is my recollection.

Q. How much of this so-called extraordinary or abnormal maintenance expense did Michigan Gas incur in the year ended June 30, 1941?

A. I think that I put in my testimony that it occurred as an item of expense in that period of about \$4,500 for the repair of a slip on a bank.

Q. I believe your testimony was \$4,572. A. Yes.

Q. Now, with respect to the \$38,000 claim for extraordinary or abnormal maintenance, so-called, am I correct in understanding that this is the total amount that you anticipate will be required in each of the succeeding years?

A. I feel that as this property grows older more money will have to be spent upon it to keep it in condition and that in my judgment is a reasonable figure to cover those expenditures, yes.

Q. Now, do you expect the amount of \$38,000 to be spent in the year 1942? A. It may not be.

Q. How about the year 1943?

A. It may be twice as much in the year 1943.

Q. And it may be nothing?

A. It may be nothing, it is a judgment figure.

[fol. 7995] Q. Now, a while ago you mentioned that the sum of \$4,572 had been expended for so-called extraordinary or abnormal maintenance for the year ended June 30, 1941. A. Yes.

Q. How much was expended in the last six months of 1941 for this character of maintenance?

A. To my knowledge, nothing.

Q. Will your state when this item of \$4,572 was incurred? A. In the fall of 1940, as I recall it.

Q. That money was spent to repair and reinforce a steep bank where a slip had occurred. Is that correct?

A. That is correct.

Q. Where had that slip occurred?

A. It was on the 24-inch line, western Indiana, at a point near Route 36.

Q. About how many miles east of Dana?

A. I would judge about five miles east of Dana.

Q. Did this slip occur on the new loop line or on the old line? By "old line" I mean the one that had been constructed in 1930.

A. I am quite sure that occurred on the 24-inch line, which was the new pipe line.

Q. And when was that pipe line constructed?

A. In 1939.

Q. Will you describe the nature of this slip of the line?

[fol. 7996] A. When that line was constructed we had built concrete breakers there. I will explain it this way: Bags filled with cement and sand were piled up at intervals along the pipe line on this steep bank.

Q. When?

A. 1939, when this line was constructed. Those breakers were put in there for the purpose of preventing the cover from washing off the pipe lines. However, in this particular case the breakers did not serve that purpose. They collapsed, evidently, by reason of the head of water which stood behind them and they were not serving the purpose for which they were intended, so we had to resort to other means in order to prevent the erosion of the covering of the pipe line.

Q. Did you have a break in the line?

A. No, no break.

Q. What type of work was done for which the amount of \$4,500 was expended?

A. We did an unusual type of work there; not so unusual for this kind of a job. We engaged a landscape gardener to sow this bank or this hill,—and it was quite sizeable,—with trees and plants so that there would be roots from these trees and plants which would prevent the erosion of the soil there.

We gave up the idea of trying to construct these breakers, which I have mentioned, in this particular location.

Q. Was any work done on the line itself?

[fol. 7997] A. None.

Q. So this amount was expended for what you might call protection against erosion?

A. That is correct.

Q. How was this sum of \$4,500 charged on the books of Michigan Gas Transmission Corporation?

A. It was charged to maintenance.

Q. As an operating expense?

A. As an operating expense.

Q. In the year 1940 was there any other so-called extraordinary or abnormal maintenance expense incurred other than the \$4,500 amount that you just described?

A. Not to my recollection, no.

Q. And there was not any in 1941, was there?

A. No.

Q. Was there any in 1930?

A. No.

Q. 1938?

A. No.

Q. How about 1937?

A. Yes, there was an item of about \$7,000 charged to expense at that time, resulting from the repair of these pipe line breaks at the end of January 1937.

Q. Those are the breaks in the line that are described in your Exhibit 77, Pages 15 to 17, inclusive, is that correct?

[fol. 7998] A. That is correct.

Q. Your company has never budgeted itself for any such item as "Extraordinary or abnormal maintenance" in the past, has it?

A. It has not.

Q. As a matter of fact, no such item appears on the books of your company as such?

A. No.

Q. Does your 1942 budget include any such item?

A. No, I do not recall that it does.

Q. Mr. Young, referring to the two breaks that occurred in Line A in 1937, which you are describing in Exhibit 77, isn't it a fact that those two breaks were occasioned by reason of overloading the line?

A. I think in this exhibit here—

Q. (Interposing) You refer to Exhibit 77?

A. Referring to Exhibit 77, that subsequent to the time that those breaks occurred I learned the line had been constructed for a working pressure of 325 to 350 pounds and at the time the break occurred, the first break occurred at 440 pounds on the outlet of Montezuma compressing station.

Q. In other words, at the time the break occurred, Michigan Gas Transmission Corporation was operating at a pressure in excess of that for which the line was originally designed?

A. That is correct, although my understanding at the [fol. 7999] time was that the line was good for 450 pounds.

Q. But subsequent tests showed that not to be the fact?

A. Well, of course, this experience demonstrated that, and in addition to that I had occasion to go over the line with the person who built it, after these breaks occurred; and he told me that the line had been built for 325 to 350 pounds:

Q. Well, don't you state at pages 15 and 16 of your written testimony in Exhibit 77, "The construction superintendent in charge of the 20-inch pipe line east of Raccoon Creek with whom the construction was discussed at a later date stated that the pipe line had been constructed for an operating pressure of from 325 to 350 pounds per square inch gauge"?

A. That is a fact.

Q. Well, it is a fact that you were operating that line at pressures in excess of 350 pounds?

A. Yes. At the time the breaks occurred the pressure out of Montezuma station was 440, that is, the first break the pressure out of Montezuma station was 440 pounds.

Q. And what was it when the second break occurred?

A. That is shown on Page 15 of Exhibit 77. The pressure when the second break occurred was 375 pounds.

Q. Well, does your allowance of \$38,000 contemplate the operation of your lines at pressures in excess of those for which they are originally designed?

A. No, not at all.

[fol. 8000] Q. Now, if the Commission were to allow for operations and maintenance for the year 1942 and 1943 and in the future the same amount as that which was recorded on the books of your company in 1940, there would be automatically included at least the sum of \$4,500 for extraordinary maintenance, would there not?

A. That is correct, that was included in the pro forma statement that was put in before-hand.

Q. What was included?

A. This \$4,000.

Q. Yes. To the extent that it was included in the operations and maintenance expenses in the pro forma statement, there is a duplication in your extraordinary or abnormal maintenance?

A. I believe I stated in my direct testimony that the amount was to be \$43,500, if I recall correctly. I gave consideration of that, I recall, but I do not recall just how it was covered in my previous direct testimony.

Q. I have no recollection of any such figure as \$43,000 in your previous direct testimony. I understood you to say a moment ago, Mr. Young, that \$38,000 was all that was required for extraordinary or abnormal maintenance.

A. Over and above what was included in the pro forma, year ending June 30, 1941.

Q. Well then, in reality you are asking for an allowance of \$42,572 per year for this item, are you?

[fol. 8001] A. That is what it amounts to, yes.

Q. Now, I would like to discuss with you for a moment the \$30,000 per annum for the so-called extraordinary and abnormal maintenance on pipe lines.

A. Yes.

Q. Is it contemplated that that character of expenditures are those which will be charged to expense as maintenance?

A. Unless some of these repairs that have to be made would be in the nature of renewals. In that case they would be handled in another way.

Q. Well, you have given a list of items on Page 1872 of the transcript which is comprehended by your estimate of abnormal and extraordinary maintenance for pipe lines.

A. What number was that, please, Mr. Littman?

Q. 1872. Now, the first of these is repair of large washouts caused by high water and heavy rains. What do you mean by a "large washout"?

A. Well, I would say that that would be the type that we had at this hill that I mentioned a few moments ago. There was a considerable washing away of the soil covering the pipe line by reason of heavy rains.

Q. You are here speaking of the washout of the earth above the pipe?

A. That is correct.

Q. Not of the pipe, itself?

[fol. 8002] A. Well, it might be the pipe, itself.

Q. Well, suppose you had a washout of the soil or erosion of the soil which does not entail any replacement of pipe. Would all of those costs be included in this \$30,000 figure?

A. That does not involve any replacement of pipe, did I understand you to say?

Q. ~~My~~ hypothetical example did not involve any.

A. If there was a washout which does not involve any replacement, I would say that that should be charged to maintenance, yes.

Q. And you in your \$30,000 item include such an item?

A. It is intended to, yes.

Q. Now, suppose you have some replacements in addition to that. Let us suppose one length of pipe is required to be replaced by reason of a washout. Would your estimate cover such an item?

A. Yes, it would. That is, if that is a renewal and I do not know whether it is or not. That is something that I have not checked in the record to find out.

Q. Suppose you have two lengths of pipe that are washed out and are required to be replaced. Would your allowance cover such an item?

A. It is intended to, yes.

Q. You would say the same for three, four, five or six lengths, would you?

[fol. 8003] A. If those are renewals, yes. I do not know whether those are property units or not, but if so I would say that this contemplates covering that.

Q. What do you mean by a "renewal"?

A. Well, again, I am not an accountant, but my general understanding of a renewal covers the replacement of some item of equipment or material which is listed in the classification of accounts as a property unit.

Q. You mean a replacement?

A. Yes.

Q. If you have a length of pipe that is taken up and replaced by reason of corrosion, do you call that a renewal?

A. If the length of pipe is a property unit.

Q. Your allowance then covers not only renewals but the other character of expense known as maintenance?

A. That is correct. I think that Mr. Spitznagle amplified that later.

Q. What size of renewal is contemplated by your \$38,000 estimate? Suppose you give us the largest one that you had in mind when you made this estimate.

A. Well, this was a judgment figure, Mr. Littman. I do not think that I could put my finger on anything that would cover this situation.

Q. You cannot name any such item?

A. Well, any items that are defined as units of property in the Classification would be covered by this item.

Q. Any items that are not called a unit of replacement are also covered by this item?

A. I have termed those "maintenance". That is as an engineer and not as an accountant I have said that this amount of money which I have asked for here is what, in my judgment, I think is necessary to cover these—

Q. (Interposing) I recall your testimony to that effect on direct examination and that is why I am asking you to describe the items that you had in mind rather than to tell me precisely how it is to be charged.

A. I see.

Q. Now, you cannot tell me or describe for me the largest item comprehended by your entire estimate, can you?

A. No, I do not believe I can. It is whatever is defined in the Classification of Accounts as units of property which apply to this property.

Q. Now, this allowance also covers repair of pipe line and river crossing breaks, does it not?

A. That is right.

Q. According to your testimony at transcript 1872, is that right?

A. Will you state that again, please, Mr. Littman?

Mr. Littman: Read the question, please.

(Whereupon, the pending question was read by the reporter.)

[fol. 8005] The Witness: That is correct.

By Mr. Littman:

Q. Now, what is the smallest item of repair of pipe line that is comprehended by your estimate?

A. Well, any item of pipe line repair is comprehended by necessity.

Q. Suppose you have an ordinary leak caused by corrosion that requires merely a repair by a leak clamp. Would that be included within this estimate?

A. No, that would not be included in this estimate because we have had repairs of that nature to make right along. I would say that our record of maintenance cost heretofore would reflect the cost of making such repairs as that.

Q. What kind of repairs to pipe lines are comprehended by this item "Repair of pipe line",—well, "Repair of pipe line and river crossing breaks"?

A. Well, I would say that that comprehends major pipe lines, perhaps, involving a renewal of some pipe.

Q. Well, a repair is not a renewal, is it?

A. Well, I have so termed it. I do not know whether that is a correct terminology.

Q. You have also included here the cost of applying cathodic protection where the nature of the soil and inspection of the pipe indicates that the pipe is being actively corroded and might corrode to a serious extent if [fol. 8006] any corrosive measures are not taken. Does your estimate contemplate covering that situation?

A. There is some difference of opinion as to the proper method of charging that item. I would say that this amount of money which I have asked for at least contemplated the renewal of cathodic protection. There is a question of whether it is required to cover new installations by cathodic protection.

Q. Does Michigan Gas Transmission Corporation have any cathodic protection on its lines now?

A. Yes, it does. There is an experimental cathodic protection installation at the present time. It is not of the conventional type. Yes. There is just the one.

Q. Just the one?

A. One installation, that is correct.

Q. How much did that installation cost?

A. My recollection is that it cost between \$3,000 and \$4,000.

Q. Well, since it is an experiment it may or may not be successful, depending on the outcome of the experiment, is that correct?

A. That is correct.

Q. Nonetheless, your estimate covers it, does it?

A. As I say, there is some question with regard to how these new cathodic protection installations should be charged and there is a question in my mind at this time

[fol. 8007] as to whether a new cathodic protection installation should be charged to this amount of money which I have asked for to cover special situations.

Q. How is this particular cathodic protection charged on the books of Michigan Gas Transmission Corporation?

A. It has not been charged as yet. We are holding that in an account or will be holding it in an account pending a ruling as to the method by which it should be charged.

Q. Well, if it is charged to capital, what effect would that have on your estimate?

A. I do not think it would have any effect on the estimate because there should be some provision in this account to take care of the renewal of that cathodic protection or, at least, the parts of it that need to be renewed.

Q. Well, you take care of that out of your depreciation reserve for short-time property, wouldn't you?

A. I do not think so.

Q. \$6,000 of the \$38,000 is for "extraordinary or abnormal maintenance" of compressor stations, is that correct?

A. That is correct.

Q. Now, will you name the items that are comprehended by this estimate?

A. Well, I can name a number of items that might be comprehended in that \$6,000.

Q. Well, you are not sure about whether they are or are not.

[fol. 8008] A. I am not sure what they will be. A power cylinder, compressor cylinder, connecting rod, crank—

Q. (Interposing) A what?

A. A crank.

Q. What is that?

A. An engine crank, crankshaft.

Q. Crankshaft. What else?

A. Well, I could go on, perhaps, and name a hundred parts of the engine that might be covered by this item which I have referred to.

Q. Those items are the ones which immediately come to mind?

A. Those are major items that come to mind. There are a great many renewals which are not units of property and which would be handled as maintenance items.

Q. Would it cover a cylinder liner?

A. If that is,—well yes, it would cover a cylinder liner; whether it is a renewal or main item it is intended to cover that, however, at least, most or some of our engines do not have cylinder liners.

Q. Would it cover the building up of a piston rod?

A. We do not build up piston rods. We do not believe it is good practice.

Q. What do you do?

A. We replace them.

[fol. 8009] Q. What is "abnormal or extraordinary" about these items of maintenance at a compressor station which you have just mentioned?

A. They are items which have not occurred thus far in the life of the property which I feel, as an engineer, will occur during the balance of the life of the property and some provision should be made to take care of it.

Q. With respect to your depreciation allowances which you have set up on the books of the company, haven't you set up depreciation allowances to cover items of replacement? You call it a depreciation and depletion reserve, do you not?

A. That is the terminology used in the financial statement, I believe, but I do not believe that that checks with the presentation of this case for rate making purposes. That is, we have set up a fund intended to amortize the property over its finite life and this amount of money which I am asking for is to cover renewals and maintenance which have not occurred heretofore but which, in my judgment, will occur in the future.

Q. In other words, your estimate was made for purposes of this proceeding so as to tie in with the allowance for amortization which has been set up in the pro forma statement, isn't that right? A. That is correct.

Q. And was not intended to be used in connection with the company's own depreciation figures?

[fol. 8010] A. No, the system—and again, I am not an accountant, understand—but the system of bookkeeping prescribed for this company I do not believe would reflect that sort of thing as it was set up in this proceeding for the rate case.

Q. Then I understand your testimony to be that if the company's depreciation allowances were made in this

proceeding, then there would not be any necessity or need for an inclusion of this \$38,000 estimate, would there?

A. Will you please read that question?

(Whereupon, the pending question was read by the reporter.)

The Witness: Provided the allowances which are ordinarily made are adequate, yes.

By Mr. Littman:

Q. And, in your opinion, they are adequate, are they not?

A. I made the statement this morning that they were based on certain conditions existing, that is, they were, in my opinion, based on certain conditions existing.

Q. In other words, this \$38,000 estimate was made for rate case purposes to be synchronized and tied in with the claim in this proceeding for amortization as set forth in the pro forma statement. Is that right?

A. It was made to be used in the pro forma statement in conjunction with the amortization which was set up in that statement.

Q. And that amortization claim which appears in the [fol. 8011] pro forma statement was presented for purposes of this proceeding by Mr. Spitznagle and Mr. Green, was it not? A. That is correct.

Q. And does not reflect the system which has been set up on the company's own books?

A. I do not believe that it does.

[fol. 8018]. Mr. Littman: If your Honor please, I should now like to take up Mr. Young's exhibits. Mr. Young's Exhibits 77 and 78 had heretofore been admitted in evidence, I believe. Is my understanding correct, if your Honor please?

Trial Examiner: That is the record as it appears in my minute book. These exhibits marked for identification Exhibits Nos. 77 and 78 were received in evidence on November 18.

[fol. 8019]. Mr. Littman: We have no objection to Exhibit No. 95 entitled, "Estimated Cost of Completing Work

in Progress at June 30, 1941, and Estimated Gross Income to be Derived from the Completed Projects".

I might state in that connection that we have requested Mr. Young to supply us with a copy of the company's 1941 financial statement which we propose to offer in evidence. That financial statement will show the company's plant down to December 31, 1941, and will, therefore, include all except approximately \$30,000 of these projects that were in the course of construction at June 30, 1941, and which have since been virtually completed.

Trial Examiner: What have you to say with reference to the exhibits marked for identification as Nos. 79 and 96, both of which appear to have been identified by Mr. Young?

Mr. Littman: We have no objection to Exhibit No. 79 but we do have an objection to Mr. Young's Exhibit No. 96. We have heretofore made an objection to Exhibit No. 96 which contains an estimate of rate case expense.

The reason for our objection is we believe that rate case expenses may not be used in testing the reasonableness of existing rates. We object to this exhibit for the reasons stated by Mr. Justice Cardozo in the West Ohio Case.

Trial Examiner: Have you your citation handy, just for the record, to make the reference complete?

[fol. 8020] Mr. Littman: I am sorry, I do not have it with me.

Mr. Wheat: I may be able to give it to you, sir.

In that connection, if I may be indulged for a moment—

Trial Examiner: (Interposing) You can supply that reference?

Mr. Wheat: I can supply it and will supply it in a moment.

It has been noted that Mr. Littman indicated that he would register an objection to Exhibit 96 and he stated the nature of his objection on transcript Page 1871. He said:

"This is rate case expense. We would like to reserve an objection to this exhibit on the ground that rate case expenses are not to be considered in this case, at least

for the purpose of testing the reasonableness of the present rates."

I understand that is the ground upon which he has made his objection for the first time.

Mr. Littman: That is one of the grounds.

Mr. Wheat: Presumably, Mr. Littman's objection will extend to the allowance of rate case expense to Panhandle Eastern as well and for that reason, I think if it meets with your approval, we might go into that matter.

Trial Examiner: Very well.

Mr. Wheat: The allowance of proper rate case expense has been so uniformly upheld by commissions and courts that I think it is unnecessary to cite the many decisions on the subject. Sometimes the question arises as [fol. 8021] to the proper period of amortization of such expense, but that such expenses are allowable has been reiterated time and again.

Now, we suppose that Mr. Littman may have in mind, as the basis for this objection, to claim that the investigation by the Commission, itself, in this proceeding will show that present rates are unreasonable and that, therefore, expenses incurred by the companies to defend unreasonable rates are not allowable. Of course, no one can possibly know, until the decision of the Commission is actually rendered in writing, whether this Commission will hold the existing rates are reasonable or unreasonable, and certainly we do not believe that it is counsel's function to attempt to pre-judge that question.

In any event, the decisions of the Courts do not sustain that theory and, as a matter of fact, are directly to the contrary. I would like to cite, for example, *Driscoll et al. v. Edison Light & Power Company*, 307 U. S. 104, in which the Pennsylvania Commission had disallowed rate case expenses on the ground that, as it had found the rates to be excessive, the company should not be allowed the amount incurred in defending them. This holding was specifically overruled by the United States Supreme Court for it said:

"Even where the rates in effect are excessive, on a proceeding by a commission to determine reasonableness, we

are of the view that the utility should be allowed its fair and proper expenses for presenting its side to the Commission."

[fol. 8022] Now, Mr. Littman may perhaps seek some support for his contention in an earlier decision of the Supreme Court, namely, in *West Ohio Gas Company vs. Public Utilities Commission*, at 294 U. S. 63. I think that is the one he probably had in mind. That case, however, is also contrary to his contention.

In that case, the Court found that, although the Commission and the Court below had intended to allow rate case expense, they had not, in fact, done so, and the Supreme Court said that this constituted error, observing, in respect to the company there involved, that:

"The charges of engineers and counsel, incurred in defense of its security and perhaps its very life, were as appropriate and even necessary as expenses could be."

Not only that, but the Supreme Court in this *West Ohio* case declared that: "A different case would be here if the company's complaint had been unfounded, or if the cost of the proceeding had been swollen by untenable objections." Of course that may be seized upon, that particular sentence might be seized upon to indicate some support for its contention similar to that which counsel has apparently made.

Mr. Littman: That is what I am seizing on.

Mr. Wheat: But a reading of the entire opinion, as well as a comparison of the *West Ohio Case* with the later *Edison Case*, we think, conclusively demonstrates that this dictum in the *West Ohio Case* does not support a contention that, where existing rates are found unreasonable, rate case expenses should not be allowed.

In the *West Ohio Case*, the company involved appealed from a rate-fixing ordinance of the City of Lima, Ohio, to the Ohio Commission. The Ohio Commission prescribed a schedule of rates higher than that fixed in the ordinance, but lower than that requested by the company. The company's complaint to the Commission was, as the

Court held, at least in part justified. In the Edison Case, the Pennsylvania Commission had disallowed rate case expense because it had found existing rates unreasonable, and this action was set aside by the Supreme Court. I think that case has been entirely overlooked by counsel.

The opinion in the Edison case appears to confine the remarks of the Court in the West Ohio case concerning "a different case" which I have just read to your Honor, where a company's complaint was held "unfounded" to litigation in the Courts for in the Edison Case, which is subsequent, as you will recognize, the Supreme Court said:

"We do not refer to expense of litigation in the courts. A different case would be here if the company's complaint had been unfounded or if the cost of the proceedings had been swollen by untenable objections." (Citing in a footnote the West Ohio Gas Company v. Commission (No. 1), 294 U. S. 63, 74; Case of Wabash Valley Electric Company v. Young, 287 U. S. 488, 500.)

Now, that case was a case where that portion of the company's claimed rate case expense was disallowed which was incurred for purposes extraneous to the proceeding under consideration, and that supports the contention which we are now making that proper rate case expenditures are properly allowable.

I think I should add that when the Edison Case reached the Pennsylvania Commission again, after it had gone through the United States Supreme Court and after the United States Supreme Court had issued this strong decision, which is directly contrary to the suggestion made by counsel for the Commission, that Commission, to-wit, the Pennsylvania Commission, reversed its former action in disallowing rate case expense incurred in the Commission proceeding, and, in obedience to the decision of the Supreme Court of the United States on that question, allowed that expense and I refer now to the decision to be found at 40 P. U. R. (N. S.) 146, the discussion being at Pages 169 to 172.

We submit that rate case expense is, in every sense, a proper and necessary allowance and that an exhibit showing estimated rate case expense is, of course, a proper portion of the testimony in a case such as this.

Mr. Littman: May I inquire, Mr. Wheat, is it necessary to take rate case expense in consideration in testing whether the rates are reasonable?

Mr. Wheat: Precisely. That is just what the United States Supreme Court said in the opinion which you ap-[fol. 8025] parently overlooked entirely.

Mr. Littman: If you Honor please, I have not overlooked a thing as counsel says. Perhaps my position might require some further comment, in view of the decisions that Mr. Wheat has read.

Now, in the West Ohio case the ordinance fixing the rates at Lima was held by the United States Supreme Court to be unreasonable and confiscatory. In that event it has always been the law that rate case expenses are allowable, because, obviously, the amount that the company had expended in defense of its life, so to speak, was allowable to it where its contentions had been found to be justly made and reasonable and where the expenses were not found to be swollen with untenable amounts. So that case is no authority for the proposition cited by counsel because there we had an unreasonable ordinance. We had there a finding that the rates of the company were reasonable.

Now, the law has always been, at least up to the time that the Driscoll Case was decided, that you never include rate case expenses for the purpose of determining, in the first instance, whether the rates are reasonable. Now, that must necessarily be so because the first inquiry that we have is this: Are the rates of the company reasonable?

Now, if by the expenditure of large and vast sums of money in connection with rate case proceedings, the com-[fol. 8026] pany should expend large sums, you certainly cannot include those in their operating expenses for the purpose of determining, in the first instance, whether their rates are reasonable or not.

What you do is, first, determine whether the rates are reasonable and then, if it is found that the rates are reasonable, an allowance is made for rate case expense to be amortized over a reasonable period in the future. However, if the rates are found to be unreasonable, then the costs, incurred in connection with stalling and delaying

and fighting an investigation instigated for the purpose of determining whether or not those rates are reasonable, are not allowable. I say that in the face of the Driscoll decision.

The Driscoll decision is one which, to my mind, is wholly untenable and I hope some day that I will be accorded the privilege of asking the United States Supreme Court to reconsider the position it took in the Driscoll case.

Mr. Culton: Meanwhile, do you think we should pay any attention to the Supreme Court of the United States?

Mr. Littman: Just a minute, Mr. Culton, I will make myself entirely clear.

I hope it will also be accorded my privilege to assist in asking the United States Supreme Court to overrule such cases as Smythe against Ames and perhaps some others, but that is beside the point; but what I want to do here is to preserve the Commission's objection to this exhibit so that [fol. 80.7] later on it may not be said that we sat idly by and let it go in.

Mr. Wheat: Well, we will stipulate to that, that you did not do that, Mr. Littman.

Mr. Littman: That we did not do what?

Mr. Wheat: That you did not sit idly by.

Mr. Littman: This is the reason for my objection: I simply want to preserve the question for reconsideration. It has always been the law, if your Honor please, that the man who loses the lawsuit bears the costs and if the Commission should ascertain in the final instance,—and we are not prejudging that at this time,—if the Commission should ascertain in the final instance that these rates are unreasonably high and are unconscionable and that the reasonable rates are considerably below those which are now being charged, I then say in that event I hope I shall be given the privilege of arguing that the costs incurred in connection with a futile attempt on the part of the company to keep those rates high and unreasonable should be disallowed and I think that the matter can be presented some day soon to the Supreme Court in that light and that they will reconsider their decision in the Driscoll case. I

merely say that we wish to preserve the question here and we, therefore, object to this exhibit.

Trial Examiner: Let me ask, Mr. Wheat, whether it is your view that the Commission is bound to take any action whatever concerning rate case expenses in its decision in this case?

[fol. 8028] Mr. Wheat: Why, certainly, we think it is.

Trial Examiner: In what way?

Mr. Wheat: We believe that rate case expense is necessarily allowable as a part of the cost of doing business. It has been so held by courts and commissions over many years and the dictum in the West Ohio case, as I have already shown at length, has no significance whatever at the present time. The Supreme Court has specifically overruled it, with respect to Commission cases and investigations by Commissions.

Trial Examiner: Your legal expense of the rate case investigation would either be operating expense or income deduction, would it not?

Mr. Wheat: It is operating expense, your Honor. It might be, of course, amortized over a period of years. Commissions have usually held where a large amount of rate case expense is involved that an amortization over three or five years or some period such as that is a proper way to handle the accounting for it and, of course, no objection could be made to proper methods of accounting, but what we are objecting to is the fact that counsel stands here with a decision of the United States Supreme Court flying in his very teeth and makes the statement that he does not like what the Supreme Court has said.

Well, a good many of us, possibly, have not entirely agreed. Sometimes we have not, when we were on the side of the minority, with the Supreme Court of the United States but, nevertheless, we are bound by the decisions of [fol. 8029] the Supreme Court so long as they remain the decisions of the Supreme Court.

The soundness of this entire determination seem too clear to us that we don't feel we need to argue it any longer. Counsel has admitted that the Driscoll case in con-

trary to his contentions and I, again, wish to read one sentence, "Even where the rates in effect are excessive, on a proceeding by a commission to determine reasonableness we are of the view that the utility should be allowed its fair and proper expenses in presenting its side to the commission."

Citing from the West Ohio case, there is this statement:

"The charges of engineers and counsel, incurred in defense of its security and perhaps its very life, were as appropriate and even necessary as expenses could be."

That is all we need to say on an objection such as that.

Mr. Littman: Well, it might be quite a bit of encouragement to these companies to spend sums of money unjustly and continue—

Mr. Wheat: (Interposing) Mr. Littman, that has been a situation which has faced commissions and both regulatory bodies and the regulated entities during the entire history of regulation in this country since it began many years ago and I have not burdened this record with the hundreds of decisions of State Commissions that have, as a matter of course, allowed rate case expense. I felt merely that we ought to bring the Commission's attention, how [fol. 8039] ever, to the fact that the United States Supreme Court, itself, has definitely ruled upon this matter and we believe that this exhibit or any exhibit in a case like this, dealing with the rate case expenses is, of course, allowable.

I am not saying, Mr. Examiner, that this Commission cannot determine what is a reasonable rate case expense. Of course, it may. But that reasonable rate case expense is proper has been held so many times that we think the matter is finally determined.

Trial Examiner: I would like to inquire, if your view were accepted, if you would consider an estimate made evidently some time early in 1941 would be considered the most satisfactory evidence as to the cost of a rate case.

Mr. Wheat: Not at all.

Trial Examiner: We are now approaching March of 1942.

Mr. Wheat: Not at all, your Honor. The facts as to the actual expenses are, of course, the facts which the Commission will finally wish to have, but the estimate of what those expenses are to be, the best estimate of what those expenses are to be, the best estimate that can be made at the time the testimony is being given, is not inadmissible because it is an estimate, because throughout the proceedings we deal with estimates.

Mr. Lee: Now, your Honor, that was what I was going [fol. 8031] to ask Mr. Wheat. Isn't it inadmissible on the ground that it is not best evidence?

At the time it was submitted, it was an estimate. Now, they have actual costs, at least down to date. Also, in the production of those actual costs, wouldn't the Power Commission desire testimony that could be interrogated so as to aid them in arriving at the reasonableness of the charges?

Trial Examiner: Exhibit 96 for identification bears at the foot a note which says: "As of June 30, 1941, none of the above fees and expenses have been set up on the company's books."

Mr. Lee: That is right. Now, is it not objectionable at this point because it is not the best evidence?

Trial Examiner: We will receive in evidence at this time the exhibit presented by Mr. Young marked for identification as Exhibit 79 and we will defer the ruling as to exhibit marked for identification 96.

(Exhibit No. 79 Was Received in Evidence.)

[fol. 8032] (Exhibit No. 95 Was Received in Evidence.)

Mr. Baldridge: I do not think I have much to add in addition to what Mr. Wheat has said, but I should like to point out that when Exhibit 96 for identification was offered in evidence it was certainly the best evidence obtainable at that time.

Now, it may be true that we may desire to supplement that in the light of experience. For one thing, this rate

case has lasted longer than was expected at that time, certainly longer than was expected by us, but at the same time it seems to me that for the time being it is subject to being modified by definite expenditures as they can be determined.

Since the exhibit was offered in evidence and ruling was deferred pending cross examination it seems to me that it should be accepted at this time and put in evidence for what it is worth.

Now, one further word in connection with some of the [fol. 8033] matters that Mr. Littman stated. I should like to point out the difference between the cases arising in Ohio and the cases arising in the way that this case arose. The practice in Ohio is for a municipality to pass a rate ordinance which becomes prima facie the rate to be charged. That rate is attacked affirmatively by the utility if it is not satisfied by filing a complaint and an appeal within a certain length of time.

Mr. Littman: With the Ohio Public Utility Commission?

Mr. Baldrige: With the Ohio Public Utility Commission. If that is a complaint appealed as filed, it might well be said that the utility is, in a sense, the aggressor and is commencing the action and, to that extent, may not be defending itself, but in a proceeding such as this which was commenced by the City of Detroit and the County of Wayne by bringing adversary proceedings against the two defendant companies and, on the other hand, by investigation commenced by the Commission itself, it certainly cannot be said that the companies were the aggressors and they are certainly in the position of defending their rates and, in a sense, their very lives.

Mr. Littman: What would you say, Mr. Baldrige, if the utility—

Mr. Baldrige: (Interposing) Just let me finish, Mr. Littman. I do not want to interrupt you.

Incidentally, these rates were filed with the Federal Power Commission and presumably, are reasonable as a [fol. 8034] general rule as to rates because no other rate

can be charged under the law until they have been changed. There, again, the companies in defending those rates are in the position of defending their rates as they exist at this time. They have to defend.

Mr. Littman: They do not have to defend them, Mr. Baldrige.

Mr. Baldrige: You have to defend them if you believe in them.

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[fol. 8037] HENRY C. LEHN a witness, having been previously sworn, resumed the stand and testified further as follows:

Cross-Examination.

By Mr. Littman:

Q. Mr. Lehn, you have presented Exhibit No. 80 entitled "Report of Inspection by H. C. Lehn in Equipment of the Compressor Stations of the Michigan Gas Transmission Corporation", have you not? A. I have.

Q. Will you briefly state what equipment is covered by your Exhibit 80?

A. The main compressor units in each station, the [fol. 8038] auxiliary units furnishing the power for lights, power, pumping, the pumps, for furnishing the jacket water, the heating system, the water treating.

Q. Now, this equipment is located in three compressor stations? A. It is.

Q. Those are the only three compressor stations operated by Michigan Gas Transmission Corporation. Is that right?

A. That is right.

Q. Those are Montezuma compressor station, the Zionsville compressor station and the Edgerton compressor station. Is that right?

A. That is right.

Q. At Page 1 of your exhibit 80 you make the following statement: "The Worthington Pump and Machinery Corporation received a request from the Michigan Gas Transmission Corporation to furnish the services of an engineer for the inspection of the equipment in their compressor stations to determine the ratio between the value of the

equipment when installed and its value as of June 30, 1941". Is that correct? A. Correct.

Q. And is that what you have done?

A. That is what I did, yes.

Q. And the results of that study are shown in Exhibit 80? A. They are.

[fol. 8039] Q. Now, do you mean by the statements which I have read that you have determined the ratio between the value of the main compressor equipment at Montezuma compressor station when installed and its value as of June 30, 1941?

A. Well, not to be strictly exact, whether there would be any difference or not as of the date when I examined it, which, of course, is somewhat later. The request specified June 30.

Q. Well, aside from that point?

A. Aside from that—

Q. (Continuing) I am going to ask you this: Do you mean from the statement which I read you, for example, that the ratio between the value of the main compressor station at Montezuma compressor station when installed and its value as of June 30, 1941, is 96 percent?

A. That was the figure that I read. That was on the basis of my considered judgment.

Q. Your answer to my question is yes?

A. Yes.

Q. And the same is true with respect to the other compressor stations, is it not?

A. It is.

Q. Except that you found a different percent in each?

A. That is correct.

Q. In other words, are you stating that the main compressor equipment at the Montezuma compressor station, for example, has a present value equal to 96 percent of the value of that equipment when originally installed? A. Yes.

Q. In short, the present value is equal to 96 percent of its original cost?

A. Of its original value to the company. Its present value to the company I consider as 96 percent of its value to the company when installed; to the purchaser.

Q. When installed?

A. When installed or put into operation.

Mr. Lee: Pardon me. That value at that time was determined by the book cost?

The Witness: I gave no consideration to the book cost; it was the value to the company as equipment for delivering gas.

Mr. Lee: Do you mean to say that, if you will pardon me—I do not want to interrupt Mr. Littman there, but it was so unusual—your idea, at least I think it was, that the value originally was 100 percent to the company and the value now is 96 percent but neither the original nor the present has any relation to what the company paid for the equipment?

The Witness: Not from my viewpoint. I considered only the physical deterioration.

Mr. Lee: But before there was anything, it was 100 percent. It had that value, 100 percent value to the company [fol. 8041] and no relation to the cost to the company?

The Witness: Not from my standpoint, no.

Mr. Lee: Isn't that most extraordinary?

The Witness: I do not know.

Mr. Lee: You are the fellow that sold it, aren't you?

The Witness: Yes, I assisted in it.

By Mr. Littman:

Q. Now, you sold a number of these compressor engines to Michigan Gas Transmission Corporation, did you not?

A. The Corporation has sold a number, all of these in question at the two stations, Montezuma and Zionsville.

Q. Now, they are all Worthington machines, aren't they? A. At the two stations.

Q. And most of them are Worthington machines at the other stations?

A. No, the main units are not.

Q. Well, confining ourselves to the main units which are Worthington units, your company sold these machines brand new to Michigan Gas Transmission Corporation?

A. Yes.

Q. Is that right?

A. That is right.

Q. And they paid you a certain sum of money for them, didn't they? A. They did.

[fol. 8042] Q. And were they worth what the companies paid you for them?

A. We considered them so at the time.

Q. And you consider that they paid you their value at the time, right? A. Yes.

Q. And you say that you have made a determination of the ratio between the value of the equipment when installed and its value as of June 30, 1941, have you not?

A. Yes, that is correct.

Q. So that if a machine is, today, in 96 percent condition, according to your estimate, then its value today is 96 percent of its value when installed. Right?

A. On whatever basis you want to take that value when installed, whether it be purchase value or any other value.

Q. Well, what value would you say these machines had at the date they were purchased other than that which is represented by their purchase price?

A. Well, I do not know just what basis it would be put on, except that I did not consider any money value of the engines in making these figures. I gave no consideration to that. I would consider that beyond my province in what I am supposed to do.

Mr. Lee: If you will pardon me, didn't you predicate your 100 percent value upon the cost?

[fol. 8043] The Witness: No, I did not predicate it on any cost.

Mr. Lee: Well, shouldn't you?

The Witness: I shouldn't?

Mr. Lee: In common sense, shouldn't you do it?

The Witness: Well, let me put it this way, they have a certain value in delivering a certain amount of gas.

Mr. Lee: That is what they are made for, that is what you are paid for, aren't you?

The Witness: That is what we are paid for and at the time I examined them, as far as I know, and I believe it is true, they were delivering the same amount of gas. On that basis they would be 100 percent.

Mr. Lee: I am not questioning you on that. I am just asking you why don't you relate your 100 percent, identified with the cost of the equipment? You say you do not do that.

The Witness: I did not in this particular case.

Mr. Baldrige: May I interject? Perhaps this might be shortened a little bit.

Mr. Littman: Just a minute. We are cross-examining this witness. If you have any objection, I wish you would state it.

Mr. Baldrige: I will. I think you are cross-examining him on something I do not think he testified to at all.

Mr. Littman: That may be your opinion, but I would like to have this witness' opinion on his exhibit.

Mr. Baldrige: After all, we have to get the facts, Mr. [fol. 8044] Littman. There is no use playing on words.

Mr. Littman: We are not playing on words. Let me ask you this, Mr. Lehn: Assume that the value of a main compressor engine, when originally installed, was \$100,000. Assume that you have placed a 90 percent condition on that engine by your method described in Exhibit 80.

Is it your testimony that under those facts the value of the machine today is \$90,000?

The Witness: On the assumption that the value to the purchaser was \$100,000, my figure of 90 percent would be \$90,000.

Trial Examiner: You are making a difficulty out of this examination. Exhibit 80 seems to indicate that Mr. Lehn's testimony is based solely on the physical condition of the property.

Mr. Baldrige: That is what he said.

Trial Examiner: Page 7 reduces that to a tabulation which indicates that at the time of the inspection the depreciation or the deterioration of the property was indicated by a certain percentage.

Mr. Baldrige: That is right.

Trial Examiner: Irrespective of amount. If you want to apply this to your purchase price or present day cost, why, that is your starting point.

Mr. Baldridge: That was his testimony on it and that was the purpose of my objection, that we were going afield.

[fol. 8045] Mr. Lee: Yes, but your Honor, everything that you have just stated he understands correctly, but aren't we allowed to ask him if the percentages are applicable to the cost price? That is all we are doing. He says, "No, it has no relation to the cost price."

Mr. Baldridge: He said not quite that.

Mr. Lee: He said that. I will ask him the question.

Have your percentages as to the condition of this equipment as set forth in the exhibit any relation to the cost price of the equipment?

The Witness: They would be applicable to any value which the customer might put on them and that would be included, yes.

Mr. Lee: That is what we are shocked at. He is trying to create a value to the customer and we are contending that he is bound by the value of the cost to the customer. Haven't we got a right to examine him on that?

Trial Examiner: Well, the Examiner just naturally assumed your starting point was the actual cost in this case, because you have a recorded cost and a present state of preservation or service.

Mr. Littman: That is what I understood the testimony to be, that the 96 percent, for instance, which he found today represents 96 percent of the cost when originally installed; Was that your testimony?

The Witness: It can be applied to any value which you [fol. 8046] wish to put on them.

Mr. Wheat: I think all he has said is that if somebody wanted to start with something else he still would go on with 96 percent.

Mr. Baldridge: Mr. Examiner, this testimony must be taken in relation with other testimony and that is this: All that Mr. Lehn is testifying to is that he is a man who knows engines, and he went down and looked at these engines from a physical standpoint and saw what percent of condition those engines were in. That is all he has testified to.

Mr. Lee: If you will pardon me, he has gone one step further. If you will just pardon me, he says that the original 100 percent valuation is not confined to the original cost.

Mr. Baldridge: That is where it ties in with the rest of the testimony.

Mr. Lee: Didn't you say that, Mr. Witness?

Mr. Baldridge: You will find that this is carried on further. If his percentages are applied, when we got down as far as our pro forma statement, they apply to the original cost of property.

I mean what Mr. Lehn has testified to has nothing at all to do with valuation, has nothing at all to do with original cost, it has to do with physical machines. He went in and looked at the machines, they were practically new, but not quite new, so he said that they are not 100 percent [fol. 8047] new, they are 98 percent new, 96 percent new.

Now, it seems to be making a lot of difficulties about something that just is not in there. If there are any words which mislead anybody, we can readily stipulate those out.

By Mr. Littman:

Q. Mr. Lehn, will you define the word "value" as it appears in the first paragraph of your Exhibit 80?

A. The worth of the property to the owner.

Q. I am sorry?

A. The worth of the property to the owner, that is my idea, on whatever basis he wished to evaluate it and whatever basis he did, its value now, in my judgment, is 96 percent, its value or its worth.

Q. Well then, your 96 percent could be applied to almost anything, couldn't it?

A. Yes; I leave that to somebody else's judgment.

Q. Were you making any effort to determine the value in dollars of these machines?

A. I was not.

Q. Mr. Lehn, will you please turn to Pages 4 and 5 of Exhibit 801? Am I correct in understanding that two main [fol. 8048] units were^a installed in the Montezuma station in 1936 and two in 1937 and two in 1940?

A. That is correct.

Q. You found an over-all depreciation of 4 percent on those six machines; did you not? A. I did.

Q. Will you state the depreciation which you found on each of the two units installed in 1936?

A. I did not make the extensions of my figures in that way. I added up the total hours and took the average of the total for the station as a part but not the entire basis of the figure which I stipulated. It had a bearing on it but not an exact numerical bearing.

Q. Now, suppose you describe the method that you used in arriving at these condition percentages. Let's take the Montezuma station as an example.

A. I found no physical depreciation or deterioration present which would permit of any figure being allotted to it.

Q. So you did not deduct anything for any observable physical depreciation, is that a correct statement?

A. Not quite.

Q. Well, you did not observe any depreciation?

A. I did not observe any depreciation.

Q. Since you did not observe any depreciation, that would leave the machines in 100 percent condition?

[fol. 8049]. A. It would.

Q. In so far as those factors were concerned?

A. It would. I gave consideration to other factors involved in, you might say, a qualitative sense, not a quantitative sense. I did not numerically weight them. In all the factors qualitatively involved, I arrived at this figure of 96 which is my considered judgment.

Q. Now, let's go back over that for a minute and see if I understand what you did. You went to these three compressor stations and you looked at the main engines. There was nothing that you could see and there was noth-

ing that you did see that would cause you to place any depreciation on those machines for those factors?

A. That is correct.

Q. Now, you did, however, arrive at a percentage of depreciation for the machines in each compressor station, did you not? A. I did.

Q. What factors did you take into consideration in arriving at the percent of depreciation which you did, in fact, deduct?

A. In addition to the observed physical condition, I did consider, and to almost completely dismiss it, the possible life of the engines of this type, the operating life and for the reason that in spite of my rather lengthy experience with compressor stations or perhaps in spite of [fol. 8050] it, I am not able to arrive at any basis of depreciation based on the life of the engines.

Q. And you did not use the life of the engines as a basis?

A. I considered it, as I say, qualitatively and arrived at a judgment figure but not a numerical figure. For example, along this line I took occasion to inquire into the situation with regard to our first engines built in 1902 which are still in operation. I was advised that those engines are in service daily as required and for the same period as any of the newer engines at the particular station and just as much is expected of them. Their delivery in gas is just as great and just as much as when installed. So on that basis, what are we going to take for the life of the engine?

Q. Did you or did you not consider the life of engines in arriving at your condition percents?

A. I considered it to this extent and I state it somewhat similarly in the exhibit. A station obviously will not go forever. It has already run and time has elapsed so, therefore, there must be some time deducted for the time it has run. I am at a loss to pin it to any definite numerical basis.

Q. Did you base it in part on operating efficiency?

A. I did in part on operating efficiency and the general condition of the engines and what I know of the main [fol. 8051] tenance and back of that, the manner in which

these engines have been erected at Montezuma and Zionville.

Q. Well, the condition of the engines, so far as you have observed, were 100 percent? A. They were.

Q. So you did not deduct anything for that. Now, you deducted something for age? A. Yes.

Q. How did you arrive at the amount that you deducted for age?

A. As I say, not by any numerical computation but simply as a matter of judgment. I cannot very well go back of that or beyond it.

Q. Well, did you make a computation to relate the expired hours of service for each machine to the total hours of life that you would expect?

A. I started to but, as I say, confirming my idea of what the engines will do, long life and the information which I got from our first engines, I abandoned it as a basis for computation.

Q. Why did you abandon it?

A. Because there is no life that I know of that has been determined. These 40-year old engines, from all accounts, will go on just as well for another 40 years. You can be assured, if I could find a satisfactory method to [fol. 8052] calculate this on a strict mathematical basis, I would be about the first one to do it.

Q. No one knows how long these machines will last?

A. I do not think they do.

Q. You have been in this business all your life, have you, Mr. Lehn?

A. Practically.

Q. That is, with the Worthington Pump Company?

A. Yes.

Q. And you are unable to give us any estimate of the life of the type and character of the machines that are now installed in the main compressor stations of Michigan Gas?

A. Well, reverting again to these original engines, if the wearing parts are replaced and that, I understand, is not to be considered here, simply the maintenance, I can not see why they would not go on for another 40 years, again not considering the question of obsolescence or exhaustion of the field or the fact that they are of no further use to the operator.

Q. That would put a life figure on these machines of approximately 45 years, would it not?

A. I do not understand where you get the additional 5 years.

Q. You say that these machines that were originally installed in compressor stations can run for another 40 years?

A. No, I meant the original engines that had run for [fol. 8053] 40 years.

Q. The original engines installed?

A. In 1902 or 1903.

Q. I see.

Mr. Wheat: On some other company's property?

The Witness: Some other company's, yes. I cite those and they are engines that followed along in successive years that are operating under the same conditions.

By Mr. Littman:

Q. You have no opinion as to the life of the main Worthington compressor unit, such as that which is installed on Michigan Gas Transmission Company's lines, have you?

A. By that you mean useful life at reasonable efficiency?

Q. Yes, in service.

A. No, I have not, providing they are maintained, the wearing parts are replaced. Of course, we could take the 40 years that these engines have run as a limit but that is simply an assumption. You might just as well take 30 or 50.

Q. You cannot state the life of Worthington machines of the character owned by Michigan Gas?

A. No.

Q. Expressed in engine hours either, can you?

A. No, I cannot for the same reason.

Q. And why is it that you cannot prescribe an age to these machines?

[fol. 8054] A. Because up to the present time, engines of practically the same type are still in service and delivering 100 percent capacity and 100 percent of hours as are required. At the same time, they would not endure forever but what their limit is, I will not attempt to say.

Q: Do you know an engineer by the name of P. McDonald Biddison?

A: I know him, yes.

Q: Do you know that he has estimated the life of the main compressor units in this proceeding?

A: I believe he has, yes.

Mr. Baldrige: But not of Michigan Gas Transmission Corporation.

Mr. Littman: No, of Panhandle Eastern.

The Witness: Yes.

By Mr. Littman:

Q: Do you know the method he used?

A: I read some of his testimony.

Q: Do you agree with the method he used?

A: He has made an assumption which may or may not be true. I do not know.

Q: What do you think about it?

A: I think not.

Q: You do not agree with Mr. Biddison?

A: I do not agree in that respect on that point.

(fol. 8055) Q: Am I correct in understanding that your 100 percent represents the value to the owner on the date when it is installed new?

A: Yes.

Mr. Wheat: When this engine is installed new?

Mr. Littman: I was referring, of course, to the compressor engines.

By Mr. Littman:

Q: What is zero percent condition under your theory?

A: I cannot conceive of zero percent if the engine is still in existence and operative. If it is entirely destroyed, it would be zero, of course.

Mr. Littman: Will you read that answer back?

(Whereupon, the last answer was read by the reporter.)

By Mr. Littman:

Q: I do not believe you answered my specific question.

Mr. Lehn: I want you to define zero percent condition as you understand it.

A. I can hardly carry these numerical percentages down to that extent. Any engine which is running at all, I would say, would be at least 75 percent or no gas company would operate it. To my way of thinking, we cannot extend it down to zero.

Q. You do not believe that a compressor engine can go down to zero percent condition?

[fol. 8056] A. It would still have scrap value.

Q. When is zero percent condition reached?

A. From the standpoint of the operator, if he has no further use for the engine, I might consider that zero percent.

Q. You might, but you are not sure about it?

A. No, not too sure. As I said before, I have attempted, to the best of my ability, to give a quantitative value to what I consider a qualitative question and it cannot be consistently carried too far.

May I amplify that a little bit?

Q. Yes.

A. I could give what I have considered definite percentages to the value of an engine if it were on the assumption that the amount of gas that it was delivering had gone down from the amount guaranteed due to poor operation or poor adjustment or something of that sort. If it were delivering 75 percent of the guaranteed amount, I would say without prejudice to the fact that it could still go lower at that particular time, the engine would be in 75 percent condition. On that basis, I would feel justified in giving exact and rigorous mathematical percentages to the value of the engine. That is one basis which occurs to me.

Q. Have you ever seen a compressor station at zero percent condition?

A. No, I have not.

[fol. 8057] Q. How about one out on the scrap heap?

A. It would still have scrap value.

Q. Now, excluding the scrap value or salvage value from consideration, when is zero percent condition reached on a compressor engine under your theory?

A. When it would no longer be capable of operating or delivering gas and could not be rehabilitated to the extent of being operative and delivering gas.

Q. That is when it is retired from service because it no longer serves its useful purpose?

A. That might be zero value to the owner at that time under those conditions.

Q. And it might not?

A. It might not have a resale value at that time.

Q. I was excluding salvage.

A. I meant beyond salvage or scrap.

Q. Have you ever seen an engine in 50 percent condition?

A. Again, I would not know how to determine an engine in 50 percent condition except under the condition which I have described of its ability to deliver the amount of gas proportional to the guaranteed quantity. That, I think, would be a rational basis for naming a definite percent of a low value.

Q. What would you expect the salvage value of the compressor station equipment of Michigan Gas Transmission Corporation to be 24 years hence expressed in per cent of the present worth?

A. It would depend entirely on the market; how anxious Michigan Gas was to sell and how anxious a customer could be found. I do know of some of the old engines which have changed hands recently at what I would consider low figures, possibly 15 or 20 percent of their initial value or the value of what they would cost at the present time.

Q. What is your best judgment of the salvage value of compressor equipment of Michigan Gas Transmission Corporation 24 years hence?

A. I would hesitate to state an opinion.

Q. Can you give us a general idea? Fifty percent, 40 percent?

A. Any figure I would name would be just a pure guess. I would be as well satisfied in my own mind with one as another so I do not see how I can give you a figure.

Q. In other words, it would be pure speculation, wouldn't it?

A. I think it would be.

Q. Will you please turn to Page 6 of Exhibit 80. You state on that page "The company which I am connected with has built in the past 40 years over 520 units of this type totaling over 500,000 horsepower. With few excep-

tions these engines are all running at the present time. Some are out of service by reason of gas becoming exhausted at their original location and not being required [fol. 8059] elsewhere. A number have been moved to different locations, in some cases two or three times. To my knowledge, none have been abandoned due to their being worn out.

Do you have records showing where these 550 units are installed and now located?

A. We have complete records of where they were originally installed, and in the majority of cases, where they are now, that is, those which were moved but not complete records.

Q. Do you have complete records as to where they were originally installed?

A. Yes, sir.

Q. And you have incomplete records as to where they are now located?

A. We have partial records of some that were moved but some were moved without our knowledge.

Q. Do your records show the date of original installation?

A. They do.

Q. And in instances where they have been removed to new locations, you know the date of their most recent installations?

A. In some cases.

Q. Do you have records of the number of hours that each unit was operated in the year 1939-1940?

A. No, we have not.

[fol. 8060] Q. You do not keep any records—

A. (Interposing) No, we do not keep records like that.

Q. Do you know how many hours these machines were operated?

A. No, I do not, except in some special cases where we have contact with a particular customer and have access to their records.

[fol. 8062] Q. Mr. Lehn, in arriving at your estimate of depreciation on compressor station equipment of Michigan Gas, did you give consideration to wear and tear?

A. By wear and tear, you mean deterioration which is recovered by renewal of parts?

Q. By wear and tear, I mean depreciation which is caused by wear and tear.

A. No, I did not. If I understand your question correctly, that is, for example, wear of piston rings, packing, cross head guides which are periodically renewed, restored.

Q. In other words, you would consider those items as maintenance?

A. Yes.

Q. And therefore, exclude—

(Continuing) Any depreciation that you observed on those items from your determination?

A. I excluded them.

Q. What about decay? Did you give consideration to decay?

A. Well, I hardly think there is such a thing as decay of cast iron, steel. There is rust, of course, if it is idle and not properly protected, but with an engine in operation, I do not think we could consider that decay occurs.

Q. You did not see any?

[Vol. 8963] A. I saw none.

Q. Did you give consideration to inadequacy?

A. If by inadequacy you mean the inability to perform the service expected, that was 100 percent.

Q. Did you give any consideration to obsolescence?

A. Not in a tangible form, I considered it in allotting that 4 percent, for example, to the 96 percent. There might be such a thing as obsolescence but there is no evidence of it yet in this type of engine.

Q. Did you consider the possibility of future obsolescence?

A. To some extent, but there, again, the length of time which the engine will be in the service of the company, and that, again, is also beyond my province.

Q. Well then, you say you considered it and made some allowance for obsolescence?

A. I considered it, to some extent, possibly intangibly, in the allotting of that 4 percent. I cannot segregate the 4 percent, as I have explained before. I cannot break that down into the various factors.

Q. As a matter of fact, one of the major causes for replacement of these machines is obsolescence, isn't it?

A. Well, to my knowledge, none have ever been replaced with another type. The type, itself, has not become obsolete, that is, has not been substituted exclusively in [fol. 8064] any case by another type.

Q. Well, they may keep them on the line and running, but they are not as good as the new ones that come out, are they, by reason of design or improvement?

A. There are very minor improvements made every few years, but they are not of such a type that they affect the efficiency of the engines. For example, we have rearranged the piping to make them more convenient, to make the maintenance and overhauling simpler. Beyond that there have not been any major changes. Material has been improved, of course, due to the advance of the art of metallurgy.

Q. Did you consider the element of changes in the art?

A. That is what I had in mind, yes.

Q. That is, you considered that along with the element of obsolescence?

A. To a very limited degree, yes.

Q. Did you consider that because of changes in demand and the requirements of public authorities?

A. No, I cannot say that I did.

Q. You did not consider it at all?

A. Not from that phase. I do not at the moment just see what bearing that would have.

Q. Well, you did not consider it? A. No.

Q. Did you consider the possibility of exhaustion of the [fol. 8065] natural gas resources of this company?

A. Not in my determination of the figure. That, also, is beyond my province which was only to examine and determine upon the mechanical condition, the physical condition of the unit.

Q. You did not consider any of the functional causes of depreciation but purely the physical causes?

A. Purely the physical.

Mr. Wheat: Pardon me, Mr. Lattman. I wonder if the witness understood your technical term "functional causes". May I ask if you included in that term and placed such causes as obsolescence? Various people in

clude different things under the term "functional causes". If you did, I wonder if the witness understood you.

Mr. Littman: I understood the witness to say that he considered, to some degree, the possibility of obsolescence and so when I used the term "functional" I mean the cause by reason of the claimed exhaustion of the gas and, possibly, the changes in the demand and requirements of public authority.

By Mr. Littman:

Q. Would the testimony that you have given thus far with respect to compressor engines apply equally to those manufactured by companies other than the Worthington Pump Company?

A. Yes, they would. In this respect I would make no distinction between them.

[fol. 8069] Trial Examiner: The exhibit [market] for identification as No. 80, offered in connection with the testimony of Mr. Lehn will be received in evidence as Exhibit 80 without objection.

[fol. 8070] F. S. HABERLY a witness, having been previously duly sworn, resumed the stand and testified further as follows:

Cross-Examination

By Mr. Littman:

Q. Mr. Haberly, we will first take up your Exhibit No. [fol. 8071] 82 entitled "Accrued Depreciation on Compressor Structures, Measuring and Regulating Structures and Equipment, Other Transmission System Structures and General Equipment as of June 30, 1940."

Will you state what property of Michigan Gas Transmission is covered by your study of accrued depreciation in Exhibit 82?

A. The property covered by Exhibit 82 includes the property in Account 352.1, compressor station structures and improvements; property in Account 352.2, measuring and regulating station structures and improvements; Ac-

count 352.3, other transmission system structures; certain property in Account 354.1; compressor station equipment, namely, the water tanks and their foundations, and the cooling towers and their foundations; also the property in Account 354.2, measuring and regulating station equipment; and the general equipment in Accounts 372, 373, 374 and 377, namely, office furniture and fixtures, transportation equipment, stores equipment and tools and work equipment.

Q. What is the original cost of the gas plant exclusive of working capital and materials and supplies?

A. The original cost, exclusive of working capital, material and supplies and any cost of developing business or going value, is \$12,261,260.55.

Q. As of June 30, 1941? A. As of June 30, 1941.

[fol. 8072] Q. I should like to have stated on the record, Mr. Haberly, approximately the original cost of that part of the gas plant which you inspected and made a determination of accrued depreciation covered by Exhibit 82. Can you state the original cost of the items of property which are embraced by your Exhibit 82?

A. Yes, sir. Account 352.1, compressor station structures and improvements, original cost was \$446,260.40 as of June 30, 1941. For Account 352.2, measuring and regulating station structures and improvements, the original cost as of the same date was \$48,566.40. For Account 352.3, other transmission system structures and improvements, the original cost as of the same date was \$27,992.58.

There was a small part of Account 354.1, compressor station equipment, [made] up of the water tanks and their foundations and the cooling towers and their foundations. I cannot, at the moment, find the original cost of the water tanks and the cooling towers but their cost was a small part of that account which, in total, was \$1,800,000-odd. It was not more than 10 percent of that account which I depreciated.

Q. Let's pass that for the moment.

A. I can find those figures but it will take a few minutes.

Q. I do not think it will be altogether necessary for our purpose at this time.

[fol. 8073] A. There were three water tanks that ran from three to five or six thousand dollars and I do not remember what the cooling tower cost was.

Then, there was Account 354.2, measuring and regulating station equipment, the original cost of which was \$125,826.02 as of June 30, 1941.

There was also Account 354.3, other transmission system equipment, with an original cost as of the same date of \$121.09; office furniture and fixtures of \$14,879.76; transportation equipment in an amount of \$33,837.47; stores equipment in the amount of \$1,609.47, and tools and work equipment in the amount of \$13,454.07.

Those original costs are as of June 30, 1941.

Q. Have you completed your answer?

A. Yes. I inadvertently included \$121.09 for Account 354.3, other transmission system equipment for which depreciation was not determined in Exhibit 82.

Q. Mr. Haberly, the total of the figures which you have read covering all of the structures and equipment upon which you determined accrued depreciation as shown in Exhibit 82 is, in round figures, \$712,000, exclusive of the water tanks and foundations and cooling towers and foundations, is that right?

A. I would say that is approximately correct. I have not added it up.

Q. And it is apparent, is it not, that the structures and [fol. 8074] equipment which you examined and upon which you made a determination of accrued depreciation in Exhibit 82 represent approximately only 6 percent of the entire gas plant?

A. Yes, I would say it was somewhat less than 10 percent. I have not made the calculation. If you have figured it out as being 6 per cent, I will accept that.

Q. In other words, while we have a good many accounts covered by Exhibit 82, the amount in dollars, as compared to the entire gas plant, is not very large?

A. That is correct. The larger amount of money is in the maintenance and compressor station equipment accounts.

Q. And Mr. Riddle has taken the responsibility for determining the accrued depreciation on the mains, has he not?

A. That is right.

Q. And Mr. Lehn has taken the responsibility for determining the accrued depreciation on the compressor station equipment, at least the major part of it?

A. Major portion of it, yes.

Q. One of the accounts covered by your Exhibit 82 is measuring and regulation station structures and equipment. Is that right?

A. Yes, sir, that property is included in two accounts.

Q. By the way, these account numbers that you have read, are those the account numbers of the company or are they the account numbers of the Federal Power Commission?

[fol. 8075] A. I think these are the Federal Power Commission account numbers.

Q. Did you inspect all of the measuring and regulating station structures and equipment of Michigan Gas?

A. No, I did not see all of the measuring and regulating structures. I saw the larger ones at the three pumping stations. I saw the two large ones in Detroit; the one in Fort Wayne, and seven or eight of those which were adjacent to the main transmission line. Those at some distance from the main line I did not see.

Q. Which ones did you not observe?

A. I do not have a complete list of the ones that I either saw or did not see. There are some 40 or more stations and I saw the larger ones of those but, as I previously said, those at some distance from the main transmission line, I did not see.

Q. Do you have a record here in Detroit showing the list of stations and those which you did not examine?

A. I am not sure whether my working papers show that information or not and I do not have my working papers. They were turned over to the Federal Power Commission. I have not received them back yet.

Q. I understand they were returned to Mr. Baldridge.

A. I am not sure whether those working papers show the stations we examined or not.

[fol. 8076] Q. Will you check your working papers this noon and advise us whether you can supply the information?

A. I will.

Q. I would also like to ascertain the same information with respect to the equipment in the measuring and regulating structures which you did not inspect. I presume that the same list would apply to both the structures and equipment?

A. Yes. If I did not see the regulator station building, I naturally did not see the equipment therein.

Q. How much time did you spend in making the inspections on property covered by Exhibit 82?

A. Three days.

Q. Will you briefly describe what you did and the method used by you in determining the depreciation of the structures and equipment which you examined?

A. At each location we visited, we made a general inspection of the property and then, in more detail, examined the building or the equipment, looking for signs of wear and tear, decay or any other factor which might contribute to its depreciation.

Q. And what did you do with the data which you saw?

A. We made notes so that our memory would be refreshed when we returned to the office to develop them into condition percent figures.

Q. Now, will you describe the method used to translate [fol. 8077] the data which you observed into condition percents?

A. As my direct testimony explains, we endeavored to reflect loss of value due to various factors, such as wear and tear, decay, obsolescence, inadequacy, loss of serviceability, and any other element which would contribute to depreciation and, after considering what we had seen and after considering the age of the property, a figure was placed on the various items which, as Mr. Lehn explained yesterday, was more qualitative than quantitative in consideration of the various elements contributing to depreciation.

Q. Mr. Lehn took no part in your determination of accrued depreciation, did he?

A. No, I merely state that he expressed quite well, I thought, the mental gymnastics one goes through in determining depreciation, that it is a consideration of the various elements rather than a mathematical working out of a final figure.

Q. Mr. Lehn testified, as I recall it, that he did not observe by eye any depreciation. Is that true so far as you are concerned?

A. No, I saw some physical depreciation, minor physical depreciation.

Q. You gave the so-called minor depreciation which you actually saw some weight in arriving at the condition percents?

A. I gave it consideration, yes sir.

Q. And then did you add something to that, something else?

[fol. 8078] A. Not necessarily added something to it. I gave consideration to the other factors.

Q. Now, what factors other than those which you observed by the eye did you give effect to?

A. In our physical inspection, we were looking for signs of age, wear, weathering, state of maintenance, reaction to the elements, degree of serviceability, state of maintenance, obsolescence and to the extent that any of these factors were apparent to us, they were given consideration.

Q. You mean apparent to you by the eye?

A. Yes.

Q. And that which was not apparent to you by the eye, you did not reflect in your condition percents?

A. No, I would not say that. The condition which we placed upon the property was less than was visible by eye, was lower than that which was visible by eye.

Q. In other words, you determined more depreciation in your final answer than that which you actually observed by the eye?

A. Yes, I would say that that was true.

Q. What I am endeavoring to get at is what elements did you consider in that process?

A. I would say that the one factor contributing to the figure which we placed on the property for condition percent that is not visible to the eye, is age.

[fol. 8079] Q. You gave effect to age? A. Yes.

Q. You mean you gave effect to expired life and remaining life?

A. Yes, a reflection of that ratio.

Q. Would you say that your method is the straight observation method? A. No, I would not.

Q. It was the observation method plus something else?

A. Plus consideration of age and life and functional depreciation.

Q. Would you say that your estimate of accrued depreciation reflects and includes all elements of depreciation which bring about the eventual retirement of the property from service?

A. That is exactly what I attempt to determine in placing a condition percent on property.

Q. Are you familiar with the claim that is being made in this proceeding that this project is to be abandoned in December of 1965?

A. Yes.

Q. Did you give consideration to that element of depreciation?

[Vol. 8080] A. No, I did not give consideration in my determination of condition percent to the possibility of abandonment in 1965. That I considered to fall within the determination of amortization and I was striving to get the condition of the property in normal service and throughout a normal life.

Q. Would or would not the normal life of this project extend beyond the year 1965 if it were not for a purported claimed abandonment of the project in 1965 by reason of the failure of the gas supply?

A. In its present location it would not extend beyond that date if the property were abandoned at that time, however, if the property were not abandoned then the property would have value and could carry on for a great number of years thereafter.

Q. Well, the factor of the abandonment of a project, as claimed here, by reason of the exhaustion of the natural gas supply, is a very important factor of depreciation, is it not?

A. I would say, rather, of amortization.

Q. You do not call that depreciation?

A. Not in the sense that I was determining depreciation here.

Q. Well, are you familiar with the Federal Power Commission's system of Accounts?

A. To some extent, yes.

Q. Do you know that the Federal Power Commission's Uniform System of Accounts prescribed for natural gas [fol. 8081] companies states that among the causes to be given consideration in the determination of depreciation is, "In the case of natural gas companies, the exhaustion of natural resources"?

Mr. Wheat: Well, you are speaking, Mr. Littman, aren't you, from the standpoint of the accounting for depreciation now, or are you?

Mr. Littman: I am speaking here, I am reading from the Federal Power Commission's Uniform System of Accounts.

Mr. Wheat: Yes. Well, I did not understand that the Power Commission had essayed to pass a rule to the effect that all persons shall use the word "depreciation" and all its aspects only in compliance with this particular statement. I understood that that was for the purpose of determining the accounting method of handling the accrual for depreciation. I just was merely asking to be sure that I got you straight on this.

Mr. Goodman: I am very well satisfied with Mr. Wheat's statement and I want to emphasize it, because there is, clearly, a vast difference between the fact of depreciation and the particular mode under which it may be accounted for.

Mr. Wheat: Precisely.

Mr. Goodman: After all, accounting merely has the function of making a record on books without regard to what the facts will be. In other words, the facts may be consistent or inconsistent with the particular mode of accounting and since I will argue that in the briefs in this case, I [fol. 8082] want to make clear that I want the benefit of Mr. Wheat's concession in this regard.

Mr. Wheat: I do not regard this as a concession.

Mr. Goodman: I do.

Mr. Wheat: I think it is perfectly clear in the Commission's System of Accounts that it is dealing with accounting

matters and I just wanted to make sure that Mr. Littman did not include all of the possible meanings of the word "depreciation" when he was asking this question.

Mr. Littman: If your Honor please, I think I can clarify my position by saying that the Commission has stated in the Chicago District Electric Generating case that "the true conception of depreciation leaves no room to doubt that annual depreciation expense and actual existing depreciation must be harmonized. Annual depreciation measures the diminution in service life capacity or utility in one year—actual existing or accrued depreciation is the total diminished service life capacity or utility to the date of inquiry. To accept the one while denying the other is to be illogical and guilty of employing dual standards with resulting injustices to the public or the utility."

Now, what I am undertaking to ascertain is whether or not there has been a consistent policy here in the determination of depreciation both for that which is being claimed on the annual allowance or expense side and that which is being claimed on the rate base side as the amount to be [fol. 8083] deducted.

I believe this witness has stated,—I wanted it to be stated even more clearly,—that he did not take into account the very important element of the claimed exhaustion of the gas supply.

Mr. Wheat: I just want one thing added to Mr. Littman's statement, and that is, of course, the case which recites that the Commission was not dealing with a company of finite life. That is the basic difference, of course, between natural gas pipe line companies' operations and those of an electric generating or distribution company.

Trial Examiner: At least, you have stated a contention.

Mr. Wheat: I have stated a fact, Mr. Examiner.

Mr. Littman: You see, if your Honor please, they are claiming a huge annual allowance here with which to amortize the property by reason of the claimed exhaustion of the gas supply over a remaining period of 24 years, but they do not want to deduct anything for accrued depreciation on that account.

Mr. Baldridge: Well, may I say there, this witness has not testified as to the policy of making annual accruals. He has simply testified as to the peculiar condition of the property. Because of the fact that this company has a finite life, it is necessary, of course, that the investment be returned at the end of that finite life in order to avoid confiscation of property.

[fol. 8084] At the same time the property depreciates physically and when we come to the question of accruals for depreciation or for maintenance, ordinary or extraordinary, it is necessary to keep the property in full operating condition during the full period of the life, so that the service will not fail.

However, what this witness has been testifying to is what he actually saw in the property in its present condition.

Mr. Goodman: Now, I want to underline that too, as a concession, as well. It is exactly the way I understand this witness' testimony.

He is here for the purpose of hypothetical exercise, namely, to ascertain how the particular items compared with new items, apart from their use in the business and wholly apart from the question that they would be totally useless when and if the gas supply were exhausted.

Mr. Baldridge: It is apart from the fact that this business has a limited life because of the prospective failure of gas supply which, according to our best information, will be around December 1965.

Mr. Goodman: You concede, Mr. Baldridge, do you not, that this witness in putting a condition upon property, a percent condition or a percent value took into consideration a hypothetical consideration contrary to the facts and the evidence in this case, namely, the assumption that the particular items of property would remain in existence and [fol. 8085] would have a separate value apart, from the business, at the time when they would be retired in 1965?

Mr. Baldridge: No, I do not think that you have paraphrased accurately what was said, Mr. Goodman. You have stated what was in my mind. What this witness has done is to look at physical property. He has determined that because of the wear and tear the amount of uses under-

gone and for the other reasons he stated there had been some diminution in condition of this physical property from its condition when new. He was asked to [stated] the amount of that diminution. It is not a hypothetical situation; it is an actual situation because we are dealing with actual property.

Mr. Goodman: I do not want to argue with you at this time and I will content myself with just this statement: I understood him to say and I understand you to mean that the question of whether the property will be retired in 1965 is not material to this witness' testimony. ~~He~~ predicates his valuation or percent condition or whatever you call it in complete neglect of that fact, in complete absence of any retirement date on the property predicated on the exhaustion of the gas.

Now, the age of the property then which he does consider is that age which buildings or structures would have apart from any necessity for retiring them in 1965 by reason of the exhaustion of the gas supply and, therefore, the age which he considers, which is a hypothetical physical age, is [fol. S086] the age that the property would have if permitted to remain in existence until it wore out.

Now, isn't that right, Mr. Baldridge?

Mr. Culton: Mr. Examiner, may I move the previous question?

Mr. Baldridge: I would just like to have this in the record.

Mr. Culton: I think we have had a good deal of discussion, showing our different philosophies. As a matter of fact, I believe, Mr. Examiner, we have all been discussing philosophies here for quite a while rather than cross-examination.

Mr. Goodman: I said I would have nothing further to say beyond that.

Mr. Baldridge: I do not like to accept all his words. I did not like the word, "neglect" and I did not like the word "hypothetical", but I do not believe it will serve any useful purpose in prolonging this discussion because I think, in substance, Mr. Goodman has about the same thing in mind that I have.

Trial Examiner: We are in a very important aspect of the issues of the hearing, of course, and it is entirely proper to consider and understand each other's position as we proceed.

By Mr. Liftman:

Q. Mr. Haberly, did you determine the accrued depreciation on this property in any different manner than the method that you would use on a property that had an inexhaustible gas supply?

[fol. 8087] A. No, I did not.

Q. In other words, you used the same method here as you would if you were making a determination on a property that had what Mr. Wheat has defined as a finite life?

A. I gave no consideration to any finite life. It was my understanding that the determination of amortization rates would be made by others and I was simply finding the physical condition of the property as at the moment without regard to any finite life.

Q. I should have said infinite life instead of finite life in my question, but I believe your answer has clarified your method. In other words, you gave no effect to the factor of the claimed exhaustion of the natural gas resources in this proceeding?

A. No, I did not. An entirely different method would have had to be used in that case.

Q. When you find a structure or certain equipment in 50 percent condition, does that mean that 50 percent of its life is gone and that 50 percent of its life remains?

A. Not precisely. That element is considered. A property, 50 percent of whose life is gone, might be in less than 50 percent condition or it might be in greater, depending upon how well it had been maintained, how well it was serving, the amount of necessary repairs, how well it was operating, a number of other factors have to be taken into age to life.

[fol. 8088] consideration in addition to a strict ratio of

Q. How much weight did you give to life?

A. I do not think I can answer that question directly. I give consideration to age and life but not in a mathematical weighting.

Q. Well, did you know the average age of every item of property that you inspected?

A. Yes. I know when it was installed.

Q. You had that in the back of your mind and then you had an age and then you had a physical life figure in your mind as you made these inspections, did you?

A. I did.

Q. And you translated the remaining age and reflected that in your percent condition, did you?

A. Yes, I think that is shown on Page 4 of Exhibit 82 where the condition of the measuring and regulating station structures and equipment—

Q. (Interposing) What page?

A. Page 4.

(Continuing)—is listed by years. It can be seen there that, reading from the bottom of the page up, the condition of the structures and equipment in the measuring and regulating stations is 99 percent for the years 1940 and 1941 and constantly decreases as you go up the page for some ten or twelve items, so that the condition percent of [fol. 8089] the measuring and regulating structures installed in 1931 is 77 percent.

Q. You would expect that same condition to prevail whether you gave consideration to age or not, wouldn't you?

A. No, I do not think it would. If you ignore the age completely, you might have a structure built in 1940 that was in no better physical condition than one built in 1930 but, giving consideration to age, the one built in 1931 would necessarily be somewhat lower in condition.

[fol. 8090] By Mr. Littman:

Q. You are unable to state quantitatively how much you added at any particular inspection point by reason of age?

A. I do not think I can say what weight I gave in a quantitative measure.

Q. I want you to assume, Mr. Haberly, that you are looking at a structure that is ten years old and has a life of 50 years. You know those facts when you make the inspection. I want you to assume that this structure, in so far as your visual observation is concerned, is just as good as new. That is, it is, in so far as observation is concerned, in excellent, brand new physical condition. What would be your percent condition on that structure?

A. Well, that is a hypothetical question and more or less difficult to answer. On a pure straight line basis, that structure would be in 80 percent condition. If it were in 100 percent condition physically and for all other aspects of condition, such as the building lacked any obsolescence, it was perfectly well maintained, perfectly serviceable, I would place a condition on it something in excess of 80 percent, possibly ranging between 80 and 90.

Q. Why would you do that?

A. Simply because you might have another structure built at exactly the same time with the same average life [fol. 8091] that was in, we will say, 50 percent physical condition. That would not be in 80 percent condition even though the pure straight line basis of depreciation would indicate that. It would be, in my estimation, in 50 percent condition. You could ignore life completely and the physical condition would rule entirely in that case.

Q. But I am giving you a hypothetical case where you have 100 percent physical condition, so far as observation is concerned, but you know that 20 percent of its life is gone. You say that you would not put that property in 80 percent condition?

A. No, because life is an average figure. When one speaks of 50-year life, one means that a group of property may live for 50 years. Actually, some units of it may go out in 30 years, some in 40, some in 50 and others in 60, 70 or 80 years and a piece of property that was in 100 percent condition, when it is ten years old, could be expected to live somewhat beyond the average life and would, therefore, at the age of 10 years, have a condition percent somewhat in excess of that indicated by normal straight line depreciation.

Q. But, Mr. Haberly, I am asking you to assume that this structure is 10 years old and definitely has a remaining life of 40 years. You seem to inject in your answers something that I am not assuming.

A. Are we putting a finite life on that building because [fol. 8092] it has to go out of existence at that time or that it will wear out at that time?

Q. It will wear out at that time.

A. We never know how soon it will wear out, only through averages.

Q. I am asking you to assume the wearing out forty years after you make the examination. You see, I want to ascertain how your mind worked and how you arrived at these percent conditions and, in order to do that, I must make certain assumptions to get the pure theory that you applied.

A. All right. Accepting the stipulation that it must wear out at the end of 40 years more of life and is in 100 percent condition after 10 years of life, I still feel it would be or would have a condition at the end of 10 years of something in excess of 80 percent.

Q. Now, when you place a structure or equipment in 50 percent condition, do you mean that 50 percent of its reproduction cost remains?

A. I mean it has a then value on a reproduction cost basis of 50 percent.

Q. Would you also mean that 50 percent of its original cost should be deducted for rate making purposes?

A. That is getting into the accounting aspects of the management of the property.

[fol. 8094] By Mr. Littman:

Q. Did you at any time suggest to the accountants of Michigan Gas Transmission Corporation or those accountants representing Michigan Gas Transmission Corporation that your condition percents were properly applicable and referable to original cost?

A. No, I did not suggest that to them, other than that if they were going to make a finding of original cost less depreciation as I have determined it, the percentages which I had determined would apply to original cost as well as to reproduction cost.

Q. To my mind, that kind of begs the question and I do not mean any improper inference by what I say.

In your opinion, is it proper to apply your condition percents to original cost?

A. Yes, they are just as applicable to original cost as to reproduction cost.

Q. Well, are your condition percents applicable to any other kind of valuation or cost however arrived at?

A. As of June 30, 1941, I would say yes.

Q. You can apply your percents to anything you want to apply them?

A. The only two values that I would know of as of that date would be the reproduction cost and the original cost but if there were another basis of value, I would think [fol. 8095] they would apply equally well.

Q. To which valuation or cost did you apply your condition percents?

A. To reproduction cost.

Q. You personally had no part to play in applying your condition percents to original cost, did you?

A. I do not recall at this particular moment, Mr. Littman, whether we made any application of them to any original cost figures or not. We may have done so for a reweighting of the conditions in their application to original cost. However, I am not sure. I do not recall.

Q. Whom do you mean by "we"?

A. Myself and my staff.

Q. You have no recollection of doing that, however?

A. A vague recollection that we may have made some such calculation.

Q. But you have not put any such calculation in evidence?

A. No, I have not.

Q. In this proceeding?

A. That is correct.

Q. Have you ever, in your experience as an engineer, applied your condition percents to original costs for rate making purposes?

A. Whether or not it was for rate making purposes, I cannot now state but I do know definitely that we have [fol. 8096] applied condition percents to original cost.

Q. Now, where original cost is used, Mr. Haberly, you would feel that it was proper, would you not, to make a deduction for depreciation that has accrued by reason of the claimed exhaustion of the gas supply?

The Witness: It would depend on whether the reserves for depreciation were being accrued on a straight line or sinking fund basis.

By Mr. Littman:

Q. Assume that the company in question is one which is accruing its reserves for depreciation on a straight line basis.

A. My own personal feeling in that case is that the depreciation should be deducted.

Q. For the assumed exhaustion of the gas supply so as to reflect that element, is that right?

A. Yes.

[fol. 8098] By Mr. Littman:

Q. Will you please turn to Page 3 of your Exhibit 82, Mr. Haberly?

On this page you show the compressor station structures and improvements upon which you determined the percent condition listed according to the year of construction, do you not?

A. That is correct.

Q. What is the probable future life of the compressor station structures and improvements constructed at the Montezuma station?

A. I would say in the neighborhood of 50 to 60 years.

Q. Can you be any more definite than that?

A. I think not. I did not make a more detailed study of mortality of that type of structure other than my general knowledge of the age of similar structures that have lived 40 or 45 years and are still in very serviceable condition.

Q. What is the probable future life that you had in mind for the compressor station structures and improvements in Account 352.1, the 50 to 60 years which you just mentioned?

A. As I recall, that was about the figure that I had in mind in determining the condition percent.

Q. What would you say with respect to the compressor station structures and improvements at Zionsville compressor station?

A. About the same life.

[fol. 8099] Q. The same is true of the Edgerton compressor station?

A. Yes.

Q. Is the same true of the structures in Account No. 352.23, "Other transmission system structures at Montezuma, Zionsville and Edgerton"?

A. Well, the life of those, I believe, would be somewhat shorter.

Q. What probable future life did you have in mind?

A. As I recall, I think that we had considered the entire life, the total life to be 40 to 50 years, so that the probable future life would be that figure less the expired age in each case.

Q. Now, the 50 to 60 year figure which you gave a minute ago for compressor station structures and improvements, Account No. 352.1, was that the over-all life or was that the future probable life?

A. That was the over-all life.

Q. The over-all life?

A. Yes.

Q. What is the over-all-life that you used for Account No. 354.1, "Compressor equipment", shown at the top of Page 4 of Exhibit 82, and will you please give us the figure referable to water tank and foundation as distinguished from cooling tower and foundation?

A. As I recall, I think that I considered the water tanks [fol. 8100] as having a probable life of about 50 years and of the cooling towers about 30 to 35 years.

Q. Now, those lives apply to the property which you just described, located at the Montezuma station, the Zionsville station and the Edgerton station?

A. That is correct.

Q. You also found a percent condition for Account 352.2, "Measuring and regulating station structures." Will you state the over-all life that you used in connection with those structures?

A. The structures in that account vary considerably, one from another, and some would have considerably shorter life, in my judgment, than others.

As I recall—

Q. (Interposing) Pardon me. Suppose we take the details of those structures shown at the bottom of Page 4 of Exhibit 82, starting with the Fort Wayne measuring and regulating station.

A. That is a brick structure. As I recall, I made the plans for that building myself in working for the Street

Railway years ago. That building is probably some 20 years old now and, in my estimation, should have an over-all life of 40 or 50 years.

Q. What do you say about the Detroit measuring station which was constructed in 1936? What is its over-all life?

[fol. 8101] A. I thought of that as about a 50-year life.

Q. What do you say is the over-all life of the Detroit regulating station?

A. Well, that station and those at all other locations, my recollection is that we considered those as having a probable over-all life of possibly 35 years.

Mr. Littman: Will you please read back the last answer?

(Whereupon, the last answer was read by the reporter.)

The Witness: Perhaps I should amplify that slightly. By "all other locations", I mean those other than the Detroit measuring station and the Fort Wayne station.

By Mr. Littman:

Q. You mean those that are shown at the foot of Page 4 of Exhibit 82?

A. Under the heading, "All other locations".

Q. Will you describe the types of construction for those regulating stations?

A. The majority of them are sheet metal structures on concrete foundations.

Q. What kind of frame?

A. In some cases, wood frame and in other cases, steel frame.

Q. What causes you to assign a 35-year life to those regulating stations as compared with the 40 and 50 year lives which you have heretofore given for other stations? [fol. 8102] Is that because of the nature of the structure?

A. The nature of the structure and the nature of the materials used in its construction.

Q. What is there about the nature of this latter class of structures that causes you to assign a smaller over-all life than to the other structures?

A. I think that those structures would require replacements of certain portions in a shorter period than the buildings at the pumping station locations or the brick buildings at Detroit.

Q. What is the size of these regulating and measuring stations?

A. They vary considerably in size but I would judge that the average size was from 8 to 12 feet wide and from possibly from 15 to 25 feet long, 6 to 8 feet high at the eaves.

Q. What over-all life did you use for Account No. 354.2, "Measuring and regulating station equipment"?

A. I used the same life for the regulating station equipment as I did for the structures, that is, I considered about the same life.

Q. Wouldn't the equipment outlive the structures?

A. Actually, I think it might to some extent.

Q. Will you give us a brief description of the equipment that is comprehended by Account No. 354.2, "Measuring and regulating station equipment"?

[fol. 8103] It consists of pipes running through the regulator structure coming up through the floor and running across the interior of the building at a level of about two or three feet off the floor and then down and out again and the measuring meters and shut-off valves and regulating equipment are interposed in the pipes going through the building.

Q. Those pipes are all painted, are they not?

A. Yes, they are all painted, protected from the weather.

Q. Protected from the weather by the structure, yes. You do not think those pipes would wear out in anything like 35 years, do you?

A. Actually, the pipe would last a much longer time but the necessity of rearrangement or the installation of new meters and governors would, in my estimation, make an average life of about 30, 35 years for that equipment about the figure to use.

By Mr. Littman:

Q. Will you please turn to Page 3 of Exhibit 82; you show on that page that the compressor station structures and improvements in Account No. 352.1 that were installed [fol. 8104] at Montezuma compressor station in 1940 have a percent condition of 98.1 percent.

A. That is correct.

Q. And that the 1940 construction at Zionsville has a percent condition of 97.9 percent and the 1940 construction at Edgerton has a condition percent of 97.7 percent, do you not?

A. That is correct.

Q. Now, that indicates for the 1940 construction, a percent depreciation of 1.9 at Montezuma, 2.1 at Zionsville and 2.3 at Edgerton.

A. That is correct.

Q. Now, with respect to this 1940 construction, what conditions did you observe on the structures and improvements at Zionsville and Edgerton which caused you to place them in a lower percent condition than that which you placed on similar construction at Montezuma?

A. As I recall, that is due to the weighting out of the conditions placed upon various individual structures or portions thereof which varied somewhat in condition, one from another.

Q. What did you observe that caused you to place different condition percents at the various stations?

A. I would say, from my recollection now that the physical condition at the three places covering the 1940 construction was generally the same but the resulting conditions shown here, varying somewhat as they do, are due to the type of construction at the three locations. In other words, there may have been a building at Edgerton in 1940 that I had thought of as having a somewhat shorter life than the majority of the buildings at Montezuma in 1940 which would necessarily result in a somewhat lower condition.

Q. You have testified on direct examination, Mr. Haberly, that the condition in which you found this property offers strong evidence that well maintained property does not depreciate on a straight line [bases] but depreciates less rapidly during its early life than it does in later years.

A. That is true.

Q. That is your testimony?

A. Yes.

Q. Do your condition percents on compressor station structures referred to on Page 3 of Exhibit 82 indicate the depreciation accrued less rapidly during the early life than during the later years?

A. I do not consider that there is any property at the compressor station which is in anything but its early life. It was all property of from less to a year old to about six years old.

Q. All of that property falls within the meaning of the term "early life", as you have used it?

A. Yes.

[fol. 8106] Q. Taking the compressor station structures shown on Page 3 and looking at your condition percents, it is obvious, is it not, that the rate of depreciation in these five years at least, that is, in the first five years of their lives was greater in the first portion than in the latter portion of those five years?

A. I think that is due to the type of structures included in the various years. My recollection is that the 1940 construction at Montezuma consisted of smaller buildings, more or less of the nature of the regulator station buildings than large pumping station buildings.

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[fol. 8107] (Exhibit No. 82 was received in evidence.)

Mr. Littman: If your Honor please, in line with our program of taking up the exhibits in consecutive order as presented by each witness, I would like to next take up Exhibit No. 83 entitled, "Michigan Gas Transmission Corporation-Reproduction Cost New of Plant and Property as of June 30, 1941, Exclusive of Working Capital, Materials and Supplies, Cost of Developing Business or [fol. 8108] Going Value".

I wish to make an objection to this exhibit. I propose to follow the plan here of making a motion to strike certain portions of this exhibit which, to our mind, are highly objectionable rather than to object to the exhibit in its entirety.

We move to strike the letter which appears on the first unnumbered page of this exhibit which is addressed by Mr. Haberly to Mr. G. S. Young, Vice President of Michigan Gas Transmission Corporation, dated October 27, 1941. This letter contains certain reproduction cost figures which we deem highly objectionable.

Mr. Goodman: Both the plaintiffs in this case are in complete harmony with Mr. Littman's objections and motions in connection with Exhibit 83, this one and those which are to follow.

[fol. 8111] Trial Examiner: The Trial Examiner will just interject at this point to say that however erroneously counsel may feel the rulings have been that have been made, there will be at least consistency between the pending ruling and the rulings heretofore complained of, namely, the exclusion of reproduction cost now tendered by the Michigan Gas Transmission Corporation will, by the previous ruling with reference to a similar exhibit offered by the Panhandle Company, be excluded and, of course, we all have in mind that not only exhibit marked for identification as No. 83 but also exhibit marked for identification as No. 84 and apparently Exhibit 87 at least are subject to similar objections.

[fol. 8112] Trial Examiner: Let me ask just generally, what part of it you are moving to strike?

Mr. Littman: The page to which I have already referred, namely the first unnumbered page containing the letter of Mr. Haberly. We have no objection whatever to the statement of education and experience of Mr. Haberly which is [fol. 8113] set forth in Exhibit 83 from Pages 1 to 7, inclusive. We object and move to strike Pages 8, 9 and 10. We object to and move to strike all of the figures appearing in the columns throughout this exhibit commencing from page 11 to the end of the exhibit headed, "Reproduction cost, June 30, 1941".

We have no objection to the listing of the account numbers and the names of the accounts and the original cost figures which are shown in the columns throughout the exhibit headed "Original cost".

With respect to Page 12 we object to the columns designated "Reproduction cost". That embraces the five columns at the right-hand side of the page. I believe that my objection is now specific enough to cover each and every item of reproduction cost.

In order to make it very clear, I will state, again, that on Page 41; that is with respect to Page 11 we object to the column headed, "Reproduction cost new, 1931" and with respect to all pages commencing with Page 13 and ending with the last page of the exhibit, namely, 64, we object to the figures and move to strike all of the figures shown in the column headed "Reproduction cost, June 30, 1941."

Trial Examiner: I think you inadvertently said, "Commencing with Page 13", did you not?

Mr. Littman: I made a specific motion with respect to Page 12 and, therefore, out of an abundance of precaution [fol. 8114] I mentioned Page 11, which is similar to Page 13 and all pages subsequent thereto.

[fol. 8116] Mr. Littman: Yes, your Honor. We have certain objections to Mr. Haberly's Exhibit No. 84 entitled "Michigan Gas Transmission Corporation Reproduction Cost New Less Depreciation as of June 30, 1941, Exclusive of Working Capital, Materials and Supplies, Cost of Developing Business or Going Value".

With respect to Page 1 of this exhibit, we move to strike the column headed "Reproduction cost new, June 30, 1941", and the column headed "Reproduction Cost Less Depreciation".

(Continuing) which columns are, together, headed "Cost of Gas Plant Exclusive of Working Capital, Materials and Supplies, Cost of Developing Business or Going Value."

In response to Mr. Culton's inquiry we have no objection to the listing of the account numbers under the heading "Accounts".

Mr. Littman: With respect to the remaining pages of [fol. 8117] this exhibit, commencing with Page 2 through Page 8, we move to strike all of the figures shown in the

column headed "Reproduction Cost New, June 30, 1941" and all of the figures on the column headed "Reproduction Cost Less Depreciation".

We have no objection to the descriptions of the items for the columns headed, "Condition Percent."

Mr. Culton: There is nothing stricken on Page 2?

Mr. Littman: Yes, that ought to be stricken because of the "reproduction cost new, June 30, 1941," and, also, the same is true of the footnote on Page 4.

There was another exhibit presented by Mr. Haberly to which we wish to make objection. That is Exhibit No. 97 entitled "Michigan Gas Transmission Corporation, Variation in Purchase Power of Dollars as Related to 'Gas Plant' ". We object to this entire exhibit and move that it be excluded from evidence for the reasons which I will now state.

Your Honor has excluded reproduction cost evidence in this case. This exhibit, namely, Exhibit 97, endeavors to do, by indirection what your Honor has ruled cannot be done by direction. Reproduction cost evidence in this case was tossed out the front door and here we have an effort to get it in through the back door.

If this Exhibit No. 97 is admitted in evidence, your Honor will have before him the precise effect and result as though he had included all of the evidence on reproduction cost.

[fol. 8118] Mr. Culton: Do you think it would be contaminated?

Mr. Littman: Yes, I think it would be contaminated, I think it is an infectious exhibit.

[fol. 8119] F. S. HABERLY a witness, having been previously duly sworn, resumed the stand and testified further as follows:

Cross-Examination (Continued)

By Mr. Littman:

Q. Mr. Haberly, do you have Exhibit 83 before you?

A. That is the reproduction cost new?

Q. It is your exhibit entitled, "Reproduction Cost New of Plant and Property as of June 30, 1941?"

A. Yes, I have that.

Q. In this exhibit, you show the original cost of the various accounts, do you not?

A. That is correct.

Q. What is the source of those original cost figures which appear throughout this exhibit?

A. They are taken from our analysis of the books and records of the Michigan Gas Transmission Corporation.

Q. You stated that this was "our analysis."

A. Analysis of myself and my staff.

Q. I see. Do you take responsibility for the original cost figures shown in your Exhibit 83?

[fol. 8120] A. Not entirely. We analyzed them sufficiently to permit us to determine the reproduction cost and then finally adjusted our total analyzed figures to the original cost as determined by Mr. Spitznagle, so, on page 11 of Exhibit 83, the totals there shown are actually the totals for the various accounts as determined by Mr. Spitznagle.

Q. In other words, Mr. Spitznagle made the original preliminary report on original cost which is identified in this proceeding as Exhibit No. 91, did he not?

A. Yes.

Q. And you took his work and made a rearrangement of the original cost items in the various accounts?

A. Yes. We analyzed his totals by accounts sufficiently to give us a basis for the application of indexes.

Q. You did not disturb his figures at all, in toto, did you?

A. No, sir, we simply further analyzed his figures for our purpose.

Q. What was the purpose of that?

A. For the determination of the reproduction cost by trending original cost.

Q. The first step you did was to take Mr. Spitznagle's original cost figures and analyze them and put them into the various accounts?

A. Put them into the various accounts and classification [fol. 8121] which we needed for our purpose.

Q. Would you explain how you did that, I mean, how did you analyze Mr. Spitznagle's figures? Did you make

changes from the account numbers that appear in the company's books or what?

A. The company's books, as I recall, were kept under a different system of accounts than were Mr. Spitznagle's final figures, although the property was classified in the same groups and the sole use we made of Mr. Spitznagle's figures was to have a total account figure to check to. My engineers made the analysis of the figures as shown in the company's books and endeavored to check out as closely as possible with Mr. Spitznagle's totals without going to more work than was necessary for the purpose for which we needed the figures.

Q. Did you have to make certain allocations in your analysis of original cost which appears in Exhibit 83?

A. Yes. As I recall, we made a number of allocations to the groupings which we were using for funding purposes.

Q. Let's look at page 14 of your Exhibit 83. On that page you show the 1936 construction of the Montezuma compressor station and you have various figures showing the details with respect to the original cost for foundations, floors, super-structure, lighting, heating, miscellaneous, labor, construction overheads, do you not?

[fol. 8122] A. That is correct.

Q. Where did you secure those figures, directly from the company's books?

A. Yes, those were secured from the company's books.

Q. Were they shown in that detail on the company's books?

A. Such items as foundation, floor, super-structure, lighting and heating under the item of material are as shown by the books. There may be a possible slight adjustment of a few dollars. Labor is shown on the company's books. Then, under the heading of "Heating," there are two items, unit heaters and other material. The other material was not analyzed except to get some idea of what it consisted of and then into construction overhead was thrown the various overheads and charges of an overhead nature. The items are not set up on the books. This is not a copy of the books in any sense of the word.

Q. Is there an item on the books called "Construction Overheads," \$3,185.00, which relates to the main compressor building at the Montezuma compressor station?

A. I would say that there was. I do not have the working papers with me to determine exactly, but I do not think that was an allocation of cost to that building. I think it was a totalling up of the various overhead charges charged against the main compressor building.

[fol. 8123] Q. Does the testimony which you have given with respect to the 1936 construction at Montezuma compressor station apply with respect to the balance of this Exhibit 83?

A. Generally I would say that it did, yes.

Q. Your total original cost figure is the same total as that which is presented by Mr. Spitznagle in Exhibit 91, is it not, in total?

A. I think it is.

Q. That is, you made no deductions from or additions to Mr. Spitznagle's over-all figure, did you?

A. No, our endeavor was to use the same original cost as he did as representing the same property.

Mr. Littman: If Your Honor please, we have no further cross examination with respect to Exhibit 83.

Trial Examiner: Have other counsel questions concerning Exhibit 83?

Mr. Goodman: No, Your Honor, we have none.

Mr. Littman: If Your Honor please, did you expect to rule on these exhibits as we went along, or did you propose to defer your ruling?

Trial Examiner: The ruling with reference to the evidence on reproduction cost will be deferred to give counsel further opportunity to consider the effect of the motion pending, also to supplement any previous statements with reference to the record as it is before the ruling.

[fol. 8124] Mr. Baldridge: May I say in that connection, Mr. Examiner, that Exhibit No. 97 stands on an entirely different basis from the other exhibits objected to in that it does not relate to reproduction cost?

Trial Examiner: Yes, I think that is true, and the ruling with reference to Exhibit 97 will also be deferred so that it may be discussed later if you prefer.

Mr. Baldridge: Yes, that is what I desired.

By Mr. Lattman:

Q. Mr. Haberly, in the morning session I requested you to furnish certain information with respect to the structures which you did not examine. Are you prepared to give me the information at this time?

A. Yes, the working papers which are here in Detroit do not show specifically the stations examined and not examined but I think I can answer your question in this way: Looking at page 26 of Exhibit 83, there is there listed the various measuring and regulating station structures by name, having a total original cost of \$48,566.00. The Detroit measuring station and the Detroit regulating station, the Fort Wayne measuring and regulating station, the Montezuma measuring and regulating station, and the Zionsville measuring and regulating station were examined and, to the best of my recollection, some seven, eight or nine other regulating stations were also examined. [fol. 8125] Q. How about the balance of them?

A. The balance were not examined.

On page 1 of Exhibit 82, a statement is made that in addition, measuring and regulating station structures and equipment were inspected aggregating in excess of seventy-five per cent of the investment in structures, and sixty-five per cent of the investment in equipment, and I recall now that in calculating those percentages, we added up either the original cost or the reproduction cost of those which were inspected.

Q. Do you have any working papers outside the city that will state and show which stations were not examined?

A. The only sheets that would show which were examined would be those on which we made notes, and it may well have been that, as the computations for depreciation were made from the date on these sheets were checked off and the sheets thrown away, I am not positive of that.

Q. Will you please make a check of your working papers and ascertain whether you have preserved your original notes and, if so, will you make a list of the stations which you did not observe?

A. Yes, I will endeavor to do that.

Q. Of course, if you have destroyed your notes, in that event you could not give us that information and you may so advise us.

[fol. 8126] A. I believe that by discussion with my staff I could determine what buildings were inspected, which would naturally result in giving us those that were not.

Q. I note at the foot of page 26 of your Exhibit 83 there is an item called "Not Analyzed," in the amount of \$887.00 of original cost. What does that mean?

A. That covers small charges scattered through the construction costs of the company which may have been credits or adjustments or such small charges that it was not worth while to investigate what they covered.

Q. That same term is used elsewhere in this Exhibit?

A. Through most of the accounts you will find a certain amount of property made up of quite small items, adjustments and credits which we did not deem desirable to examine because of the time it would take.

Q. That is, you felt where the item was not sufficiently large in dollars to warrant the time, that it would be best not to pursue the matter and spend your time on it?

A. That is correct. There were many items of \$1.00, \$2.00, or \$5.00 that would not materially affect the final answer.

Q. Now, will you please turn to your Exhibit 84? I will, of course, confine my questions to the column entitled "Condition Percent" and to no other figures shown in this Exhibit, inasmuch as there is a motion pending to [fol. 8127] strike all other figures.

A. Yes, I understand.

Q. Is my understanding correct that the condition percents shown in this Exhibit, which relate to the depreciation of mains were not determined by you, but were determined by Mr. Riddle? Is that correct?

A. That is correct. Those figures were furnished to me by Mr. Riddle.

Q. And you take no responsibility for them?

A. None whatever.

Q. Now, the condition percent figures which appear in this exhibit apply to compressor station equipment or, at least, most of the compressor station equipment? I have in mind by that the compressor engines. Those percents were determined by Mr. Lehn, were they not?

A. Yes, that was shown, I think, best on page 6 of Exhibit 84. At each station you will find an item there for main compressor units. The condition percent applied

against the reproduction cost of such property was determined by Mr. Lehn. The condition percentage applied against the elevated water tanks and the cooling towers was determined by myself and the condition percent applied against auxiliaries was determined by Mr. Lehn.

Q. So that what you have done is to take the various condition percents of Mr. Riddle and Mr. Lehn and your [fol. 8128] self and summarize them in this Exhibit?

A. Yes, to bring them all in one place.

By Mr. Littman:

Q. Will you please refer to Exhibit 85, which is entitled "Michigan Gas Transmission Corporation, Average Age at June 30, 1941, Estimated Remaining Life and Estimated Salvage Value of Short Life Property?" Is my understanding correct that the original cost figures shown in the first column for this property in the total amount of \$13,400.51 were derived from Mr. Spitznagle's preliminary original cost study?

A. They were either taken from his preliminary figures or from the analysis which we made of the books. I do not recall at the moment, but I do think they checked out with Mr. Spitznagle's figures.

Q. Am I correct in saying that the "percent condition" which you show in the second column was derived by you in the manner set forth in Exhibit 82?

A. Yes, in Exhibit 82.

Q. And did you make the determination of the "average age" of this property shown in the third column?

A. Yes, that is my determination.

Q. And, also, of the "remaining life" column and the "salvage value?"

A. Yes, those are my figures.

Mr. Littman: If Your Honor please, we have no objection to Exhibit 85.

Trial Examiner: The computation marked for identification "Exhibit 85" may be received without objection.

(Whereupon exhibit 85 was received in evidence.)

Trial Examiner: This Exhibit is supplementary to Exhibit 82, if I recall correctly.

Mr. Littman: Suppose we ask the witness that question. I rather doubt that it is supplementary. It does contain certain information contained in Exhibit 82.

By Mr. Littman:

Q. Will you please state whether your propose to offer Exhibit 85 as supplementary to Exhibit 82, Mr. Haberly?

A. In a measure yes. It breaks down certain figures a little further and develops the remaining life and the salvage value, and the Exhibit was prepared from Mr. Spitznagle's use in one of his exhibits.

Q. Well, perhaps I can clear up the matter this way: The condition percents shown in Exhibit 85 were not derived wholly by the application of the ratio between the [fol. 8130] 'average age and remaining life, were they?

A. No, they were derived in the same manner as those in Exhibit 82 and took into consideration salvage.

Q. Now, this exhibit was prepared, primarily, for the purpose of enabling Mr. Green to determine his estimate of annual amortization for short life property, is not that correct?

A. Yes, I believe that is right.

Mr. Littman: If Your Honor please, it forms the basis, as I understand it, in part, of Mr. Green's testimony.

By Mr. Littman:

Q. Will you please turn to your Exhibit 86 entitled "Michigan Gas Transmission Corporation, Estimated Salvage upon Exhaustion to the Gas Supply of 'Gas Plant' as of June 30, 1941?" Do [you] estimates contained in Exhibit 86 reflect the dollar amounts which, in your opinion, will be recovered by way of salvage in the year 1965?

A. Yes, the exhibit was made in order to estimate as well as could be the probable salvage which might be realized upon dissolution of the company.

Q. You are not taking any responsibility for the claim that the Michigan Gas Transmission Corporation's project and property will be abandoned in the year 1965, are you?

A. No.

Q. As I understand your testimony, you were given the [fol. 8131] problem of determining what the salvage value would be at December 31, 1965, were you not?

A. That is correct.

Q. You testified on direct examination, Mr. Haberly, that you first determined your percentages of salvage and then applied them to reproduction cost new to secure the amounts which are shown in the column headed "Net Salvage," is that correct?

A. That is generally true where a percentage is shown. There were some items where no percentage was determined, and the net salvage figure was shown. There [there] was simply an estimate made of the possible salvage which might be realized without going through the mathematics of setting it up, percentagewise.

Q. But the major items, that is the items of large amounts, were determined by the application of a percentage to reproduction cost new, were they not?

A. That is correct.

Q. Is it your testimony that the total net salvage of \$663,165.00, shown on page 1, is the proper salvage value of all the property of Michigan Gas recoverable as of December 31, 1965?

A. That is so, provided the assumption is made that the entire amount of the pipe in the mains could be sold for re-use in another location. I doubt whether it would [fol. 8132] not be unwise to go upon the assumption that there would be a market for that price for re-use.

At the foot of page 1 on Exhibit S6, there is a note to the effect that if no prospective purchaser could be found, then the pipe could only be sold as scrap and there would be no salvage on the mains because the cost of removal would exceed the amount which could be realized by selling the pipe as scrap. I personally believe the proper figure to use as salvage value would be the \$663,165.00 less the estimated salvage for mains of \$537,019.00, which is based upon the assumption that the entire amount of pipe could be sold for re-use.

Mr. Littman: Will you please read that back?

(Whereupon, the last answer was read by the reporter.)

By Mr. Littman:

Q. Well, then, your actual salvage value is not any \$663,165.00, is it?

A. No, that would be, in my estimation, the maximum salvage which could be obtained provided you could sell the pipe for re-use.

Q. What is your estimate of the minimum salvage which could be obtained?

A. About \$127,000.00.

Q. I take it, from your testimony, that you do not consider it likely that the amount of \$537,019 could be obtained for mains?

A. I doubt it.

Q. In other words, it is your best judgment at the time that Michigan Gas Transmission Corporation will not be able to salvage one cent for its mains?

A. Well, it would depend entirely upon the conditions in 1965.

Q. Well, suppose you tell me what you considered would be the conditions that would be found to exist in 1965, upon which you now base your conclusion?

A. Well, I have worked it out on two bases, one, upon the assumption that the pipe could be sold for re-use, and the other upon the basis that it could not. I would lean very strongly toward the assumption that the pipe could not be sold for re-use, that is, that there is no certainty that it could be.

Q. There is no certainty that it could not be, either?

A. That is perfectly true.

Q. What prices did you use for salvage, those which were prevalent as of June 30, 1941, or those which you expect to prevail at December 31, 1965?

A. Well, I would hesitate very strongly to estimate what the salvage value of the pipe might be in 1965, and the entire estimate of salvage is predicated upon percentages of the reproduction cost and salvage values of [fol. 8134] pipe on June 30, 1941.

Q. Well, suppose the Commission were to use original cost as a rate base for the purpose of testing the reasonableness of the rates. Would it be proper to apply your percents of salvage to the original cost?

A. Yes, that could be done, although, as I recall, I made a statement in my direct testimony to the effect that the

amount of salvage, as determined in this exhibit, could be used on either a reproduction or original cost basis.

Q. Well, if you used it on the original cost basis, you would get even less salvage than you found, would you not?

A. It would be somewhat less, yes, not materially so.

Mr. Culton: May I ask a question to get my own mind clear?

Does this show what that salvage would, today, be worth in your judgment as of June, 1941?

The Witness: Yes, it was predicated upon the fact that the prices prevalent at June 30, 1941, would be prevalent in 1965.

Mr. Culton: In other words, this page 7 in Exhibit 86 represents what you considered that salvage could be sold for as salvage net as of June 30, 1941?

The Witness: Yes.

Mr. Culton: Irrespective of what it originally cost?

[fol. 8135] The Witness: Irrespective of what it originally cost, because it was here computed on a reproduction cost basis.

Mr. Culton: By "it" I meant irrespective of what the property originally cost.

The Witness: Yes.

By Mr. Littman: In other words, you are standing on the dollar value of salvage here and not so much on the percent figure?

A. Well, I think it would be equally correct to take the dollar figure here as applying to original cost rather than to recompute it, because it is hypothetical as to what the actual salvage in 1965 will be. The only basis for it is an estimate using today's prices and when none of us know what the price level will be in 1965. It may be considerably higher or considerably lower.

Q. In other words, you would have no objection and it would not be improper to use the dollar figures of salvage which you have set forth in Exhibit 86, regardless of what rate base is used?

A. That is correct, except that in my own judgment the lower of the two figures I testified to would prevail.

Q. I understand the one qualification that you have made very clear on the record. Well, as I understand your testimony, you have determined in this exhibit the salvage value today of the property when sold in 1965?

[fol. 8136] A. Yes. I have maintained the present price level up to 1965 and assumed that we are then at the same price level salvaging the property.

Q. What conditions did you assume, those that exist today or those that exist in 1965?

A. I do not know what the conditions in 1965 will be, so I assumed market conditions as of 1941.

Q. If this property were to be abandoned tomorrow, would it be possible to sell the pipe for re-use in another location?

A. I think it would be very possible to sell the pipe. I do not know whether it would be good for use in another location, but steel is valuable today.

Q. The probabilities are that it could be sold as pipe?

A. It could be sold and well used for some purpose. I think it would probably be up to the Priorities Board as to what use would be made of it.

Q. It would not be sold as scrap today, would it?

A. I doubt it.

Q. And your answer would be the same, even though the pipe in this system were thirty years old today? Is that correct?

A. I think if the pipe were thirty years older today it would not be materially less valuable.

[fol. 8137] Mr. Goodman: Would not be materially what?

The Witness: Less valuable.

By Mr. Littman:

Q. Why don't you assume that condition which exists today in arriving at your total salvage value rather than to assume scrap conditions which you have assumed?

A. Well, in the first place, the determination was made before the war started.

Q. You mean your exhibit was prepared before the war started?

A. Yes, I do not think the war is going to last until 1965, so I do not think I would want to maintain that position at thirty years hence.

Mr. Culton: At least you hope that?

The Witness: I certainly do.

By Mr. Littman:

Q. You certainly went to a good deal of trouble to ascertain what the salvage value of these mains would be if they were sold for re-use in another location, did you not?

A. Yes.

Q. You thought enough of the possibilities to go to that trouble, did you not?

A. I started out both ways so that whichever one the Commission desired could be used.

Q. As far as you are concerned, the Commission could [fol. 8138] use either one?

A. There is nothing I can do about it.

Q. Well, I would like to know what you think about that. You put it in this exhibit. Now, if ~~it does~~ not belong in here, we would like to know it.

A. If it were my own property, I think it would be slightly over optimistic to count on selling the property for re-use in 1965.

Q. Why did you put this figure in here if you did not intend that anyone should use it? We get very optimistic when we see \$63,000 salvage and then later on we learn, when we look at Mr. Green's exhibit, that we only have \$126,000 of salvage in his pro forma statement and then we are not so optimistic.

A. Well, I set it up in both ways, one assuming that it could be sold for re-use, and one assuming that it could not. I lean more strongly to the second.

Q. In other words, your forecast of things to come in 1965 is not any better than mine or anybody's else, is it?

A. I think that is probably true.

Q. And you would not consider the use of the entire figure of \$663,165 as erroneous if it were used in its entirety?

A. No, I do not think it would be erroneous. It would be, in my opinion, the more optimistic view of what you [fol. 8139] might obtain for salvage.

Q. In your estimate of salvage for Account No. 353, "Mains," summarized on page 1 of your Exhibit 86, in the amount of \$537,019, what average price per ton did you use in arriving at that figure?

Now, before you answer that question, I presume I am correct in assuming that that is the amount you would expect as salvage in 1965 on the assumption that the pipe would be sold to a purchaser who would have occasion to re-use the pipe at another location. Is that correct?

A. That is correct.

Q. Now, let us have the answer.

A. The average price is one-half of the reproduction cost of the pipe. I do not know exactly what the average price per ton is. The figure for the total reproduction cost includes pipe at several various prices because of the price differential as to size.

Q. You are speaking of the cost of the pipe alone?

A. Yes, so I cannot answer the question specifically without making an analysis to find detail price.

Q. Do you have those figures in your working papers, Mr. Haberly?

A. I believe you have the working papers, and I do not recall now just exactly the detail in which it is set up.

Q. We hand you a copy of your working papers and [fol 8140] ask you to read into the record the price per ton.

A. I do not believe, Mr. Littman, that I can answer your question much better than I just did. Apparently the material cost on the pipe was added up exclusive of the river crossings and exclusive of the fittings of that type was at various prices due to different prices on different sizes of pipe.

Q. Can you give us an approximation?

A. I would say that in the neighborhood of \$30.00 to \$32.00 a ton was considered as gross salvage.

Q. Thank you. Have you made any estimate of the salvage value of this plant, assuming that its component parts would be replaced by reason of physical deterioration before the gas supply is exhausted as claimed in this case?

The Witness: May I hear that question?

(Whereupon the pending question was read by the reporter.)

The Witness: As I understand your question, I have assumed that the property would be maintained in adequate working condition, operating condition, up to the time it went out of service and, therefore, that the necessary replacements would have been made from time to time and it would be that property which was being salvaged in 1965.

Q. You have told me what you did. Now, I want you to tell me whether or not you ever made another type of [fol. 8141] study of salvage on the system, namely, a determination of the salvage that would be recovered from this system if the gas supply were ample for a long period in the future?

A. No, I do not believe I have.

Q. You are sure you understand my question—I am referring to the salvage that you would obtain year in and year out by replacing pipe and renewing pipe and then—

Mr. Culton: (Interposing) You mean annual salvage? I am trying to get my own mind clear is the reason for this question.

Mr. Littman: That might be one way of expressing it, that is, assuming at the end of its life the entire property had been replaced with new parts. You answered my question wholly understanding what I have in mind?

The Witness: No. If I still understand your question, I do not think I have made any such determination.

By Mr. Littman:

Q. You know whether you did or not, don't you?

A. If I understand your question, I did not.

Q. You did not make any other type of salvage study than that which is contained in your Exhibit 86, did you?

A. Except in our determination of the percent condition, we kept in mind possible salvage at the end of its natural life which was not as much as I have considered here. For instance, I would not consider that the structures [fol. 8142] would have any net salvage.

Q. Did you consider that the pipe would have any net salvage?

A. I did not make a determination on percent condition on pipe so that question did not come up.

Q. Have you made any estimate of the salvage value of the main transmission line of Michigan Gas upon the basis of its re-use in place in 1965 for purposes of carrying oil or artificial gas or perhaps water?

A. You mean in the same location?

Q. Yes.

A. The question of salvage would not arise if it were going to be re-used beyond that date.

[fol. 8143] By Mr. Littman:

Q. You made no estimate of salvage or sale of this pipe line system in its present location as of December 31, 1965, did you?

A. In its entirety, a sale in its entirety?

Q. Yes.

A. For re-use for another purpose?

Q. That is right.

A. No, I did not make any such determination.

Mr. Littman: If Your Honor please, we would like to make an objection with respect to this exhibit.

Mr. Goodman: I would like to ask just one question which will complete my cross examination. This might be a good time.

Trial Examiner: Proceed.

Mr. Goodman: In your last answer, do you mean that you excluded consideration of the possible use of the pipe line facility as it exists at the termination or rather at the exhaustion of the gas wells as estimated to take place in 1965?

The Witness: That is correct. I did not assume that the property could be re-used in its present location.

Mr. Goodman: That does not answer my question. You excluded the element of such use from consideration?

The Witness: That is correct.

[fol. 8144] Mr. Goodman: All right, that is all.

Mr. Baldridge: May I inject one question? In that case, it would not be salvage, would it, Mr. Haberly?

The Witness: No, it would not be salvage.

Mr. Littman: Before entering my objection, I would like to ask Mr. Haberly one more question.

By Mr. Littman:

Q. In the footnote on page 1 of Exhibit 86, you state that, "No. 1 heavy melting scrap as of June 30, 1941, ranged in price from \$18.25 to \$20.00 per gross ton which is less than the cost of removal, including damages and freight to the steel mills."

Will you state the salvage value of the mains if the amount of \$18.25 per ton were secured?

A. I would have to calculate it, but it would be a red figure. If the pipe were salvaged and sold as scrap, the net salvage would be a loss.

Q. Not asking you the net salvage. I am asking you to tell me how much money would be secured for this pipe if it were sold for \$18.25 per ton.

A. Excluding the price of removal?

Q. Yes.

A. I think about the best way I can answer that, Mr. Littman, is I believe I stated that the gross salvage, assuming it could be resold for use in another location, was [fol. 8145] probably about \$30.00 or \$32.00.

Mr. Wheat: Per ton?

The Witness: Per ton; and if sold for \$18.25 to \$20.00, it would be a little better than half of what they would have obtained by selling it for reuse in another location, that is, sold for scrap. That would be, however, exclusive of the cost of removing.

Q. Suppose you tell me the total tonnage of pipe in the system and then we will do our own multiplication and get the figure we are seeking.

A. I do not know the exact total tonnage, but I would judge it was in the neighborhood of about 80,000 tons.

Q. Eighty thousand tons?

A. Yes, that is quite approximate.

Q. The amount covered on the basis of \$18.25 per ton would be \$1,500,000. Does that sound about right to you?

A. That would be approximately correct. That would be gross without giving consideration to the cost of getting it out of the ground before selling it at that price.

Mr. Littman: If Your Honor please, I wish to move to strike from this exhibit, Exhibit 86, all the figures shown in the column headed "Reproduction Cost New June 30, 1941." We have no objection to the other figures in the exhibit.

Mr. Culton: Mr. Littman, don't you think the Commission might be contaminated by the fact you could apply your percent salvage to the net salvage and get back ap- [fol. 8146]. proximately what is in the first column anyhow?

Mr. Littman: If you want to have a good time doing that, you certainly are welcome to enjoy yourself. I do not think anybody else would want to do it.

I might say we want to be entirely fair about this matter. This witness has testified, and we gave him every opportunity to do so, that the dollar figure of net salvage are the dollars that he expects to recover at the end of the purported life of the project. I feel, in view of that testimony, notwithstanding the fact that this witness used a percentage applied to reproduction cost new, that the figures are not objectionable on that basis.

I wanted to state clearly on the record why we make no objection to the net salvage value or the percentage of net salvage value.

[fol. 8153] By Mr. Littman:

Q. Mr. Haberly, you applied a salvage value of 4 percent on all of the main compressor units, did you not?

A. That is correct.

Q. And that represents junk value at December 31, 1965? A. Yes.

Q. As distinguished from resale salvage value?

A. Well, we gave consideration to possible resale of, say, one out of five units and the junking of the rest.

Q. How much are you getting for the one that is being resold? A. About 15 percent of its original cost.

Q. And that 15 percent was applied on one out of every five of the main compressor units? A. Yes.

Q. Does that contemplate the resale as at December 31, 1965?

A. Of one out of five, yes, at about 15 percent of its original cost.

Trial Examiner: May I ask, Mr. Haberly, are these compressors, in general, of a type similar to the compressors used for ventilating large mines?

The Witness: I really do not know. I doubt it.

[fol. 8154] Trial Examiner: I assume they would not be limited to gas transmission, would they?

The Witness: Yes, I believe they would be confined entirely to the transmission of gas.

Trial Examiner: And they could not be used for air compression?

The Witness: I do not believe so. I am basing most of my statements on discussions with Mr. Lehn.

By Mr. Littman:

Q. Mr. Haberly, you heard Mr. Lehn testify yesterday did you not? A. Yes.

Q. You heard him say he would not even want to venture a guess as to what the salvage value of these compressor engines would be in 1965. Did you hear him say that? A. Yes.

Q. You do not agree with Mr. Lehn, do you, on that subject?

A. Yes, in a measure I do. It is problematical as to what can be obtained for these engines in 1965 but, predicating it upon what he told me of the sale of a number of engines some years ago and the probabilities of how many could be sold were some nine or ten put on the market at once and the probable scrap value that could be obtained for the others, I worked out a figure of 4 percent.

[fol. 8155] Q. Did Mr. Lehn tell you that any of his Worthington engines had ever been scrapped? A. No.

[fol. 8156] By Mr. Littman:

Q. Mr. Haberly, you also heard him testify that machines that had been in operation for 40 years were expected to last another 40 years. Did you hear him testify to that effect? A. Yes, I heard him testify to that.

Q. That would give a life of approximately 80 years on these machines, would it not? A. Yes, it would.

[fol. 8157] Q. In 1965, the oldest of these machines will have reached an age of only 30 years, approximately?

A. Something like that, yes.

Q. And according to Mr. Lehn's testimony, they would be fully expected to last another 50 years?

A. If you can find someone who can use them.

Q. Now, assuming that you can find someone who can use them in 1965 when they are something less than 30 years of age, on the average, you say that only 15 percent of their value would be recovered?

A. Yes, and that figure was based upon conversations with Mr. Lehn and I think he repeated that statement in his testimony yesterday.

Q. Did Mr. Lehn tell you what might be expected by way of resale of these machines in 1965?

A. No, I discussed the matter with Mr. Lehn and, as I recall the conversation, he was of the opinion that there would be little likelihood of disposing of eight, nine or ten machines at one time to a prospective purchaser.

Q. Well now, you confine the 15 percent to only one out of five engines in 1965? A. That is correct.

Q. And 4 percent on all the other engines.

Mr. Chamberlain: It would be much less if he got 15 percent out of one. He only assumes to recover 20 percent [fol. 8158] out of five which would leave 5 percent to be recovered out of four or 1¼ percent salvage.

By Mr. Littman:

Q. Is it correct to state that your salvage on the remaining four machines out of the five is 1¼ percent?

A. I did not approach it that way although it works out to about that, yes.

Q. And that is simply because you say you doubt whether a purchaser could be found in 1965?

A. If the gas field was exhausted, it would probably throw quite a number of engines on the market in addition

to those on this property. Probably all of those on the Panhandle system and other systems which were supplied from the same field. I am of the opinion that it would be very difficult to dispose of more than one out of five for reuse in another location.

Q. Well, if they were all sold in 1965, you would expect to receive 15 percent salvage on them?

A. If you could find a [purchaser] for each and every one, you probably could realize 15 percent.

[fol. 8159] Mr. Littman: I propose next to take up Exhibit No. 87, entitled, "Michigan Gas Transmission Corporation, Materials and Supplies, Statement of Cost of [fol. 8160] the Major Items at Prices as of June 30, 1941."

By Mr. Littman:

Q. In this exhibit you show the total cost of materials and supplies per books as of June 30, 1941, in the first column, do you not? A. That is correct.

Q. And that was in the amount of \$93,413?

A. That is right.

Q. Now, you made a certain adjustment with respect to the book figures and made an upward revision, did you not?

A. Yes, of about 58 percent of that \$93,000.

Q. No, you mean 58 percent of \$54,000, do you not?

A. No, it is about 58 percent of the \$93,413.

Q. Oh, I see. That is the 58 percent of the \$93,000 is the amount of materials and supplies, on whose costs you made a revision? A. That is correct.

[fol. 8161] Q. Now, what is the total amount of your revision? A. \$7,311.

Q. And so the upshot of this exhibit is that you added \$7,311 to the book cost of materials and supplies at June 30, 1941, of \$93,413 to obtain a total claimed amount for materials and supplies of \$100,724. Is that correct?

A. That is correct.

Q. Now, pages 2 to 8 show the details of the manner in which you arrived at the additional \$7,900?

A. Yes. Opposite each item will be shown the original cost and then its approximate present cost.

Q. You took \$54,211 of the materials and supplies on the company's books at June 30, 1941, and repriced that

amount of materials and supplies to reflect present-day prices, did you not?

A. Yes, we priced it by the application of indexes.

Q. Well, how much time did you spend on this job?

A. Personally, about a half-hour and one of the engineers probably spent about two or three hours digging up the indexes and setting them down opposite various items and then it went to a comptometer girl for calculation.

Q. Well, how did you determine how much of these materials and supplies required repricing?

A. It was not a matter of determining how much, it was [fol. 8162] done in this way: We were given a list in detail of the items of materials and supplies, the larger items. No detail lists of the smaller items aggregating about 62 percent of the materials and supplies was furnished to us. That 62 percent we made up from myriads of small items.

Mr. Baldridge: Did you say "62", Mr. Haberly?

The Witness: Yes. No, 42 percent it should be, I am sorry.

Trial Examiner: You are referring now to the—

The Witness: (Interposing)—Complement of the 58 percent.

Trial Examiner: (Continuing) —percentage computation appearing on Page 1 of this exhibit?

The Witness: Yes.

By Mr. Littman:

Q. What was your assignment in regard to materials and supplies? Was it to determine the amount of materials and supplies required by this company for purposes of this proceeding or was it purely a repricing?

A. It was a repricing, what would be their value at June 30, 1941.

Q. You are not taking any responsibility then for estimating the amount of materials and supplies actually needed or required by way of working capital by Michigan Gas Transmission Corporation?

A. No, I am simply putting it in present-day values.

[fol. 8163] Q. You went to quite a bit of trouble here to arrive at this additional \$7,000, did you not, Mr. Haberly?

A. Well, it may appear to be quite a bit of trouble but actually the indexes had been worked out for purposes of the reproduction costs of the property and the same indexes were applied to these various items, that is, the index indicating the increase in the price of a certain size of steel pipe from 1936 to June 30, 1941, was applied to that same size of pipe both in 1936 for materials and supplies purposes.

[fol. 8165] Q. Mr. Haberly, I would like to have you turn to your Exhibit 97. In this exhibit you have worked out a factor which you called "Purchasing Power at June 30, 1941, of Actual Dollars Spent on Gas Plant", have you not? [fol. 8166] A. Yes.

Q. Now, you derived that, that factor is shown and I shall not read it into the record because I am going to ask that this exhibit be excluded. You have shown it in the right-hand bottom corner of the page of this exhibit, have you not? A. Yes, double-underlined.

Q. Now, this factor was derived by the application of certain indices which you have worked up from time to time? A. Yes.

Q. And these are the same indices that you have used in arriving at your reproduction cost estimate which is shown in Exhibit 83. Is that not correct?

A. In part, yes.

Q. How much part? A large part or a small part?

A. The major part.

Q. That is, you used the same general method in Exhibit 97, for the purposes of arriving at the factor, as that which you used in Exhibit 83 in arriving at your reproduction cost?

A. That particular figure was arrived at in that way, yes.

Mr. Littman: We have no further cross-examination with respect to Exhibit 97 and we, again, move that Exhibit 97 be excluded from evidence in this case.

[fol. 8172] FRED A. SPITZNAGLE a witness, having been previously sworn, resumed the stand and testified further as follows:

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Cross-Examination

By Mr. Littman:

Q. Mr. Spitznagle, you are an employee of the Central Service Corporation? A. That is correct.

Q. What position do you occupy with that corporation?

A. An accounting position.

Q. You have presented the accounting exhibits in this proceeding in so far as they relate to Michigan Gas Transmission Corporation? A. That is correct, yes.

[fol. 8173] By Mr. Littman:

Q. Do you have before you Exhibit 88 entitled, "Michigan Gas Transmission Corporation—Comparative Balance Sheets Per Books as at December 31, 1936 to 1940, inclusive, and June 30, 1941", Mr. Spitznagle? A. I do, yes, sir.

Q. Does this balance sheet correctly represent the true financial condition of Michigan Gas Transmission Corporation as of the dates shown?

A. I think I so testified on direct examination, Mr. Littman, that it does represent the financial condition of Michigan Gas Transmission Corporation at the respective dates shown in the exhibit.

Q. As a matter of fact, Mr. Spitznagle, you have made an actual audit of the books of the Michigan Gas Transmission Corporation, have you not?

A. No. In the direct testimony, I stated specifically [fol. 8174] that no detailed audit of the books was made by myself or anybody under my supervision.

Q. But you did make an investigation of the books?

A. Yes, we examined into the property and plant account in connection with the original cost determination and examined the accounts in a generalized way.

Q. Do you have a copy of Exhibit 146 which is the prospectus of Panhandle Eastern Pipe Line Company dated January 21, 1942, relating to the issue of \$10,000,000 of first mortgage and first lien 3 percent bonds and 150,000 shares of cumulative preferred stock?

A. I have a copy of the prospectus to which you refer. I do not know it as Exhibit No. 146.

Q. Suppose you refer to that document.

A. I am afraid I misspoke myself, I do not have it here.

Q. I hand you a copy of Exhibit No. 146 and refer you to Page 74 thereof which contains a copy of balance sheets of Michigan Gas Transmission Corporation as of December 31, 1940, and September 30, 1941. I shall refer in the questions to follow only to the figures at September 30, 1941, on this balance sheet.

Will you state from this balance sheet the total of the outstanding long-term debt, common stock and surplus accounts of Michigan Gas Transmission Corporation as of September 30, 1941?

[fol. 8175.] A. The long-term debt is denoted in this balance sheet that you have referred to as notes and loans payable to Columbia Gas & Electric Corporation and are in the amount of \$8,320,500.

The capital stock and surpluses appearing in this balance sheet of September 30, 1941, are stated as follows:

The common stock, no par value, authorized 60,000 shares; outstanding 44,800 shares—\$2,240,000;

Surplus with a reference to the statement of surplus accounts contained in the prospectus, special capital surplus—\$139,500;

Capital surplus prior to January 1, 1938—\$26,662.76;

Earned surplus since December 31, 1937—\$54,177.83;

Making a total of capital stock and surplus of \$2,460,340.59.

Q. Am I correct in stating, by way of summary, that the total of the common stock, long-term debt and surplus of Michigan Gas Transmission Corporation at September 30, 1941, was \$10,780,840.59? A. Yes, sir.

Q. Is it correct to say, Mr. Spitznagle, that this amount of \$10,780,840.59 represents the total actual investment as of September 30, 1941, of Columbia Gas & Electric Corporation in Michigan Gas Transmission Corporation with the exception of an item of an inter-company fee of \$139,423.73 plus interest of \$2,200 or a total of \$141,157.73?

[fol. 817-a] The Witness: I would like to have the question read to me, Mr. Littman, please.

(Whereupon, the pending question was read by the reporter.)

The Witness: You asked me if it is the amount of money invested by Columbia Gas & Electric Company. Actually, I do not know how much Columbia Gas and Electric, as such, has invested.

I can say that the amount that you have quoted is the amount that has been paid in for the items that I have enumerated in my testimony, so-called long-term debt and capital stock and surplus. Whether it was all paid in by Columbia Gas & Electric Company, or not, and whether they paid more for their investment in those items, I do not know, Mr. Littman.

By Mr. Littman:

Q. Would you say that the sum of \$10,780,840.59 represents the total actual investment by the investors in Michigan Gas Transmission Corporation as of September 30, 1941, with the exception of the \$141,157.73 which I mentioned?

A. My difficulty is with the investment and investors. It is the amount of money that has been paid into the Michigan Gas Transmission Corporation, without question.

Q. By whoever paid it in?

A. That is right, by whoever paid it in.

Q. Don't you know that Columbia Gas & Electric Corporation has always owned Michigan Gas Transmission Corporation? A. I do.

[fol. 8176] Q. From the inception down to the date in February of 1942 when the corporation was sold to Panhandle Eastern?

A. Yes, I think that is my understanding.

Q. You know that they owned all of the outstanding common stock and all of the long-term debt, do you not?

A. They made all of the advances that resulted in the long-term debt, that is correct, yes, sir.

Q. And being the owner of the common stock, they owned the surplus, didn't they? A: That is correct.

Q. I might say, Mr. Spitznagle, that if you are finding any fault with language, it is not with my language. It

is with the language of the Securities and Exchange Commission and shall read from Page 12 of the Securities and Exchange Commission's opinion which is in evidence as Exhibit 147 as follows:

"With the exception of one item, the record indicates that the figure stated in the application of \$10,789,840.59 as constituting the investment of Columbia Gas in Michigan Gas, plus surplus, at September 30, 1941, constitutes actual system expenditures and is equal to the plant account after depreciation less the excess of current liabilities over current assets."

Does that comport with your understanding of the situation?

A. Yes, it does.

[Vol. 8177] Q. Now, are you familiar with the fact that the Securities and Exchange Commission at Page 12 of its opinion which is in evidence as Exhibit No. 147 concluded that the undepreciated portion of this intercorporate profit to which I have just referred a moment ago of \$141,157.73 was \$104,924 as of September 30, 1941?

A. I need to correct what you have just said before agreeing with your statement in this respect. The amount of \$141,000 odd that you referred to also includes, in addition to intercompany profit, an item of interest capitalized on that same amount of some \$2,200.

Q. That is a small amount, isn't it? A. That is right.

Q. But you do know that the Securities and Exchange Commission concluded as I have just stated?

A. That is correct, yes, sir.

Q. And you are in substantial agreement with that conclusion, are you?

A. I have no reason to disagree with them at all, Mr. Liftman.

Q. Incidentally, the interest item to which you refer amounts to something like \$2,200, doesn't it?

A. That is correct, yes, sir.

Q. Now, after deducting this item of intercorporate profit, there is left a balance of \$10,675,916.57 which represents the total actual investment in Michigan Gas Transmission Corporation as of September 30, 1941. Is that correct?

A. I think that is correct, subject to checking your subtraction of the figure. I could not follow you to do that.

Q. If you should find any error in the figures which I am reading and which are, of course, always subject to check, I wish you would report back on the record and correct me. A. I shall do so.

Q. But that figure sounds correct? A. It does, yes sir.

Q. Now, Mr. Spitznagle, let us see what assets this sum which I just named of \$10,675,000-odd was invested in as of September 30, 1941. I now refer you again to the balance sheet which appears on Page 74 of Exhibit No. 146 and ask you whether you find the total current and working assets as of September 30, 1941, to be \$1,673,533.50?

A. Yes, sir, I do.

Q. Now, what were the current and accrued liabilities as of that date? I mean the total, just give the total:

A. The amount is \$1,596,340.50.

Q. Now, subtracting the latter from the former gives you what amount as net working capital as of September 30, 1941?

Mr. Baldridge: May I interject a question there? I may have some objection to your question, Mr. Littman, but I do not want to unless I have to.

[fol. 8179] In what sense are you using the word "capital"? Is that the use of the word in this statement or is that a term of your own?

Mr. Littman: I am using the term "actual net working capital" as that term was used by Mr. Coffman who testified on behalf of Panhandle Eastern.

Mr. Baldridge: I think, of course, this witness is not bound by Mr. Coffman's definition. I think we ought to know what we are talking about.

Mr. Littman: I think we can clear that up, Mr. Baldridge, to your complete satisfaction.

Mr. Baldridge: Thank you.

By Mr. Littman:

Q. Mr. Spitznagle, before you answer this question, will you define the term "actual net working capital"?

A. It is generally considered, Mr. Littman, as being the net of current assets less current accrued liabilities.

Q. It is so defined in the Accountant's Handbook, is it not? A. I think so.

Q. Now, will you give me the figure which represents the actual net working capital as of September 30, 1941, reflected by the balance sheet?

Mr. Baldridge: May I suggest one change? May I suggest "net working capital" as so defined.

[fol. S180] Mr. Littman: Of course.

The Witness: The amount that you have asked me to determine is \$77,193.

By Mr. Littman:

Q. Another item on this balance sheet which represents assets in which money is invested by the owners is referred to as "deferred charges". Will you please read into the record the amount of deferred charges as of September 30, 1941?

A. The amount appearing on this balance sheet as of September 30, 1941, is \$12,418.89.

Q. There was accumulated in the reserve for "reserve for contingencies", "reserves for injuries and damages" and "other reserves", the amount of \$319,749.39. Is that correct?

A. I will have to check to see if that is the amount, Mr. Littman. \$319,749.39 is the correct amount.

Q. That is a red figure, isn't it, so far as assets are concerned?

A. That is correct. It is on the liability side of the balance sheet.

Q. This makes a total net deduction of \$230,137.50, does it not, for other assets and liabilities and so forth? That is to say, the net asset amounts to a red figure, doesn't it?

A. The net assets other than property and plant and equipment and the reserve for retirements is the amount you [fol. S181] have just stated subject to my checking the actual amount in dollars. I presume you have deducted the \$12,418.89 of deferred charges from that same amount?

Q. Yes. What I am seeking to do here is to eliminate the small items and get those out of the way so that we can discuss the gas plant and investment in gas plant. Now, the only remaining figures on the balance sheet pertain to the gas plant accounts, do they not?

A. That is correct, yes, sir.

Q. Those are "Gas Plant in Service" in the amount of \$12,617,352.68? A. That is correct, yes, sir.

Q. And from that you would deduct contributions in aid of construction in the amount of \$9,342.96. Is that right?

A. That is correct, contributions in aid of construction, for construction appearing on the balance sheet in a reserve account, yes, that is correct.

Q. You would have to deduct that \$9,000 item in order to secure the actual net investment, would you not?

A. That is right, because the amount was contributed by someone other than the company.

Q. And you would, also, have to deduct from the gas-plant-in-service figure of \$12,000,000 odd the inter-company-profit figure which we referred to a few minutes ago in the amount of \$104,924, would you not?

[fol. 8182] A. Yes, after netting the plant account by the application of retirement reserve. If you are going to apply gross you would have to take out the \$141,000 and then take something off of the reserve to compensate for it.

Q. Now, we are coming to the reserves. And you would, also, have to deduct from gas plant in service the reserves for depreciation in order to get the net investment, would you not? A. That is correct.

Q. And what amount had been accumulated in the reserve for depreciation at September 30, 1941?

A. Well, the caption on this balance sheet is "Reserve for Retirements" and that amount is \$1,597,031.63.

Q. Now, on the books of the company what is it called?

A. I think on the books of the company, Mr. Littman, I do not recall right off but I believe it is "Reserve for Depletion."

Q. Very well, we are talking about the same thing, are we not? A. Yes.

Q. Now, that leaves a net investment in gas plant of \$10,906,054.09 as of September 30, 1941?

A. It must be approximately that amount, but I have not been able to make the computation here, Mr. Littman. I will make it, if you like.

[fol. 8183] Q. I think perhaps you had better do that before we get too far afield. A. What is that figure?

Q. \$10,906,054.09. Now, that represents, does it not, Mr. Spitznagle, the net investment in the gas plant of

Michigan Gas Transmission Corporation as of September 30, 1941?

A. On the basis of the method of computing this amount, yes, that is true.

Q. Well, are you talking about the \$2,200 item now, again?

A. No, I am talking about the allocation of dollars that were invested in this business. On the balance sheet they are offset, the aggregate dollars are offset by the various items that you have just enumerated to me and on the basis of the process of elimination that we have gone through, it indicates that of the dollars invested, \$10,906,054.09 are responsive to the net plant account.

Q. And represent the net investment in gas plant at September 30, 1941? A. That is correct.

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[fol. 8184] By Mr. Littman:

Q. Now, you remember the negative or red figure that I read of \$230,137.50? A. Yes, sir.

Q. Now, you would have to subtract that from the \$10,900,000-odd figure that you would have to have to get the total over-all figure, would you not?

A. That is correct, yes, sir.

Q. Now, making the deduction, there is a total over-all investment, as of September 30, 1941, in the plant property business of Michigan Gas Transmission Corporation of \$10,675,916.59, isn't that correct?

A. That is correct, yes, sir.

Q. And that is the amount that Panhandle Eastern Pipe Line Company paid for Michigan Gas Transmission Corporation, is it not?

A. I do not know that as a fact, Mr. Littman.

Mr. Culton: I think we have so proven.

Mr. Littman: Is that the figure? Is there any question about that?

Mr. Culton: That is the figure that shows in the Securities and Exchange Commission report, is it not?

By Mr. Littman:

Q. That is the figure, do you recall?

A. I recall the figure in the release of the Securities [fol. 8185] and Exchange Commission, yes, Mr. Littman, but, as a fact, I do not know actually.

Q. And that amount represents the prudent investment in the enterprise as of September 30, 1941, does it not?

A. Mr. Littman, I do not think that is the question that runs to me, I just do not.

Q. You cannot answer that? A. No, sir.

[fol. 8229] Trial Examiner: The motion specifically is stated as to the exhibit marked for identification Exhibit [fol. 8230] 83 commencing at page 8109 and is more fully defined at page 8113. That is a four-page introduction. Pages 8, 9 and 10 of proposed Exhibit 83 are stricken and all of the figures appearing in the columns throughout the exhibit commencing from page 11 headed, "Reproduction Cost, June 30, 1941," on page 12 the five columns relating to reproduction cost are stricken, and commencing with page 13 and thereafter throughout the exhibit to its end, page 64, the column at the right headed, "Reproduction Cost New, 1941," or "Reproduction Cost, June 30, 1941," wherever they occur, will be stricken. With this revision, the exhibit is received.

(Whereupon exhibit 83 was received in evidence as above.)

Mr. Littman: If Your Honor please, what is your ruling with respect to the letter of Mr. F. S. Haberly, dated October 27, 1941?

Trial Examiner: That was overlooked and because it does include a reproduction cost figure, that, also, will be stricken.

The motion, which is sustained, with reference to the revision of Exhibit 84 is stated on page 8116 of yesterday's transcript and we will now strike from proposed Exhibit 84,—this is Mr. Haberly's Exhibit 84 entitled "Reproduction Cost New Less Depreciation as of June 30, 1941," et cetera,—the column headed "Reproduction Cost New, June 30, 1941," and the column headed "Reproduction Cost Less [fol. 8231] Depreciation" on page 1.

The columns headed "Reproduction Cost New, June 30, 1941," and "Reproduction Cost Less Depreciation," are stricken wherever they occur in the exhibit, leaving only for effective evidence the column captioned "Condition Percent," reflecting an estimated physical condition of the properties listed.

As to Exhibit 86, the motion to strike was made at page 8145 of the record and is sustained, so that there will be stricken from this exhibit all of the figures shown in the column headed "Reproduction Cost New, June 30, 1941."

The exhibits marked for identification as 84 and 86, as so revised, will be received in evidence by corresponding numbers.

Trial Examiner: The exhibit marked for identification as 97 will be excluded and it is excluded primarily because the Federal Power Commission will gain very little information of value from a consideration of mere graphs. The record in this case already contains statistical data, which this exhibit tends to illustrate, covering all of this ground and much more.

The exhibit marked for identification as 96, which was [fol. 8232] under discussion at page 1871 of the transcript and, again, at page 8020, being Mr. Young's estimate of the cost of this rate proceeding, will be excluded because it is not the best evidence at this time of the matter therein contained.

Now, exceptions will of course be noted for all parties against whom the ruling is made.

Trial Examiner: It is, of course, understood that the Trial Examiner was trying to exclude from this record all evidence which might sustain a reproduction cost estimate.

[fol. 8235] FRED A. SPITZNAGLE a witness, having been previously sworn, resumed the stand and testified further as follows:

Cross-Examination (Continued).

By Mr. Littman:

Q. Mr. Spitznagle, the accounting exhibits which you have presented in this proceeding reflect the annual period for the year ended June 30, 1941, do they not?

A. That is correct, yes, sir. I might correct that slightly. It reflects the 12-months' period ended June 30, 1941, as distinguished from "Annual" usually related to calendar years.

Q. If the 1941 revenues and expenses of Michigan Gas Transmission Corporation had been available for the full calendar year ended December 31, 1941, when you prepared your accounting exhibits, would you have presented them for that period rather than for the 12 months ended June 30, 1941? A. Yes, I think that is true.

Q. There are certain advantages in using figures for a full calendar year, are there not? A. There are, yes, sir.

Q. What are some of those advantages, briefly?

[fol. 8236] A. Well, the books of the company operating on a calendar year basis are always closed as of the end of the calendar year. Certain adjustments are made because of the necessity of using estimates for interim periods. Consequently, the interim period 12-months' reports do not always reflect the same information that you would get on a calendar year basis.

Q. And, as a matter of fact, figures for the latest full year would be more comparable with those on the books for previous years?

A. For previous calendar years, that is correct, yes.

Q. So that you would have a better basis of comparability? A. That is correct, yes, sir.

Q. Of course, when you prepared these exhibits, the figures for this full year 1941 were not available?

A. No, sir, because they were prepared before the end of the year 1941.

Q. The figures for the full year 1941 are now available, are they not? A. That is true, yes, sir.

Q. Are those figures fully reflected in the financial statement for the year 1941 of Michigan Gas Transmission Corporation? A. Yes, sir, they are.

Q. Do you have a copy of that financial report with you? [fol. 8237] A. Yes, sir, I do.

Q. It goes without saying, does it not, that the books of Michigan Gas Transmission Corporation have been closed for the year 1941?

A. That is my understanding, Mr. Littman.

Q. You have caused sufficient copies of this 1941 financial statement to be distributed to counsel and to be made an exhibit in this case, at my request?

A. I did not but the officials of Michigan Gas Transmission Corporation did, Mr. Littman.

Q. Do you have those copies with you?

A. Yes, sir, we do.

Mr. Littman: Mr. Examiner, I would like to have marked for identification as Exhibit No. 163, the document to which the witness has just referred entitled, "Columbia System—Financial Statement of Michigan Gas Transmission Corporation (Unassigned)" for the period ended December 31, 1941.

Mr. Wheat: Mr. Littman, I wonder if you would let me ask this. I have no record of Exhibits marked 160 and 161. I may just have an income, etc. record.

Mr. Littman: You may or may not recall that at the very close of the last session held in Washington, I offered two exhibits; namely, Exhibits No. 161 entitled, "Estimated Main Line Sales and Revenues—Years 1941-1946, Inclusive", and Exhibit No. 162 entitled, "Estimated Sales to Detroit, 1941-1951, Inclusive".

[fol. 8238] Mr. Wheat: What about Exhibit No. 160?

Mr. Littman: Exhibit No. 160 was offered by Panhandle Eastern Pipe Line Company and is entitled, "Panhandle Eastern Pipe Line Company—Purchase Agreement", dated February 2, 1942.

Mr. Wheat: I had missed that. My record has not been brought up to date. Thank you.

Trial Examiner: This will be marked for identification as Exhibit No. 163.

(Exhibit No. 163 was marked for identification.)

By Mr. Littman:

Q. Will you please explain the term "unassigned" which appears in the title of Exhibit No. 163 for identification?

A: I do not believe I can. In fact, I never noticed that word appearing on this exhibit. Where do you read it from the one which you put in evidence?

Mr. Baldrige: Was Exhibit 163 marked for identification?

Trial Examiner: It was.

Mr. Baldrige: It has not been put in evidence so far, am I right?

Trial Examiner: It has not been offered.

By Mr. Littman:

Q. So far as you know, the term has no particular significance?

[fol. 8239] A. It has none to me, Mr. Littman.

Q. Have you prepared a supplementary statement to the financial statement which has just been identified as Exhibit No. 163?

A. There was such a statement prepared by the company, Mr. Littman, yes, and we have copies of them here.

Q. I hand you a copy of a document consisting of two pages which I have been advised is a supplementary statement to Exhibit No. 163. Is that the document to which you have just referred? A. It is, yes, sir.

Mr. Littman: If your Honor please, I would like to have marked for identification as Exhibit No. 164, a document of two pages purporting to be a supplementary statement to the 1941 financial statement of Michigan Gas Transmission Corporation.

Trial Examiner: It will be so marked.

(Exhibit No. 164 was marked for identification.)

By Mr. Littman:

Q. Does Exhibit No. 163 and its supplement, Exhibit No. 164, bring down to December 31, 1941, all figures in your accounting exhibits except those which are shown in the pro forma statement, Exhibit No. 104?

A. They do, yes, sir.

Q. Do you propose to present a new pro forma statement based on the figures for the year ended December 31, [fol. 8240] 1941? A. I do not, no, sir.

Q. Do you propose that the pro-forma statement, Exhibit No. 104, be relied upon as a forecast or guide for the future?

A. I have no opinion regarding that Mr. Littman. I had none in the first instance as to Exhibit No. 104.

Q. You had a job to do and you did it?

A. Only in so far as there was factual information contained in that statement.

Q. We will, of course, discuss Exhibit No. 104 a little later, inasmuch as it is our program to take your exhibits up in the order in which they were presented.

Would you say, Mr. Spitznagel, whether the figures contained in Exhibits No. 163 and No. 164 were taken from the books and records of Michigan Gas Transmission Corporation?

A. In my opinion, they were, Mr. Littman. I have checked them sufficiently to ascertain that fact.

Q. Are the figures set forth in Exhibit 163 and 164 in accordance with the Commission's Uniform System of Accounts for Natural Gas Companies?

A. I think they are, Mr. Littman.

Q. At the close of yesterday's session, we were discussing the matter of the net investment in the plant and property of Michigan Gas Transmission Corporation as of September 30, 1941. Can you, by reference to Exhibits 163 and 164, determine the net investment in the gas plant [fol. 241] of Michigan Gas Transmission Corporation as of December 31, 1941?

A. Yes, sir, that is obtainable from Exhibit 163.

Q. Now, you would determine that in the same manner as it was determined yesterday by you during the afternoon session?

A. That is correct, with this addition. There has accrued additional depreciation on the excluded item of \$141,000 odd which would have to be computed and not directly taken directly from the report.

Q. About how long would it take you to determine the net investment in the gas plant of Michigan Gas Transmission Corporation as of December 31, 1941?

A. Well, it would take me some little time. I would prefer not to try to do it sitting here on the stand.

Q. Could you make such determination conveniently during the noon recess? A. I think so, Mr. Littman.

Q. Will you do so, please? A. I will try it, yes.

Q. Thank you. Will you please turn to your Exhibit No. 89. I refer you to Line 8, "Dividend Appropriations—Common Stock". Are the amounts set forth on that line all of the common stock dividends that have been paid from the date that Michigan Gas Transmission Corporation commenced doing business in 1936 to June 30, 1941? [fol. 8242] A. They are, yes, sir.

Q. You do not show in this exhibit or in any of your exhibits, other exhibits, the percent of dividends as related to the paid-in value of the common stock, do you?

A. No, sir.

Q. Will you please state what those percentages are for each of the years 1936 through 1941?

A. I would have to compute them before I stated them and I have not computed them yet, Mr. Littman.

Q. That would only take a few minutes, would it not?

A. Well, it takes a little division to find out how much the stated value of the common stock was for each of those years. I presume I have it here somewhere.

Q. The stated value of the common stock is shown on your balance sheet, Exhibit No. 88, is it not? A. Yes, sir.

Q. I observe that on Page 2 of Exhibit 88, there appears the amount of \$2,240,000 as "Common—No Par Value" for each of the years 1936 through 1940 and down to June 30, 1941.

A. That is correct. You wish the percent return of the aggregate amount of dividends for the whole period as applied to the average stated capital of \$2,240,000?

Q. Yes, by years.

A. You want it by years and you also want the aggregate for all of the years?

[fol. 8243] Q. Yes. Mr. Spitznagle, while you are doing that, I would like to have you include the amounts for the full year 1941 which are reflected, of course, in the financial statement for that year, to-wit, Exhibits 163 and 164.

A. For the year 1936, the dividend of \$112,000 paid in that period is equal to 5 percent of the stated value of \$2,240,000 for common stock.

For the year 1937, the comparable percent is 4 percent.

For the year 1938, the comparable percent is 8 percent.

For the year 1939, the comparable percent is 24 percent.

Mr. Montgomery: What was that figure, again, please?

The Witness: 24 percent.

Mr. Wheat: That is for 1939?

The Witness: That is correct.

For the year 1940, the comparable percent is 19.

Do you wish the same information, Mr. Littman, for the 12-months' period ended June 30, 1941?

Mr. Littman: I believe the figure for the year ended December 31, 1941, would suffice.

The Witness: I would think so too and by the same token, for the six-months' period appearing in this statement, you do not want that because it would be historic.

Mr. Baldridge: Do you mind if I inject one question here?

Mr. Littman: Would you mind letting him read the next figure into the record and then the total?

[fol. 8244] Mr. Baldridge: All right.

The Witness: For the Year 1941, the comparable figure is 29 percent.

Mr. Littman: Now, that makes a total of 89 percent of dividends paid on the stated value of the common stock during the life of the corporation?

The Witness: Yes, sir, that is correct.

Mr. Baldridge: May I ask my question now? What is the ratio between the stated value of the common stock and the present book investment of the company as of the last date? I believe that last date is December 31, 1941.

The Witness: Do I follow your question, Mr. Baldridge, that you want the ratio of the stated value of common stock?

Mr. Baldridge: To the net book investment.

The Witness: To the net book value of the gas plant?

Mr. Baldridge: Yes.

Mr. Littman: Or do you mean the net book value of the common stock?

Mr. Baldridge: No, I want the ratio between the stated value of the common stock and the net book investment to indicate what percentage of the investment is represented by the common stock.

Mr. Wheat: May I ask, too, that the witness, in connection with that answer, tell us—I do not know whether he did in answer to one of your questions, perhaps I did not hear it—whether this stated value of the common stock is the [fol. 8245] same through all these years you have mentioned?

The Witness: It is.

Mr. Wheat: What is that figure?

The Witness: \$2,240,000.

Mr. Wheat: Thank you.

Mr. Baldridge: The total net book investment, as indicated by all securities of the company, including long-term debt outstanding, I mean capital stock, surplus, bonds, notes and other forms of securities—

Mr. Littman: (Interposing) As of what date?

Mr. Baldridge: As of the last available date, I think December 31, 1941. I think I stated including surplus too, of course.

Mr. Littman: Of course, the surplus amounts will vary each year.

Mr. Baldridge: Yes.

The Witness: I will answer your question in part first by saying that the total long-term debt is \$8,320,500; capital and surplus is \$2,372,081.13 and the total long-term debt and capital and surplus is \$10,692,581.13.

The ratio of the stated value of the common stock to the total long-term debt and capital and surplus is 20 percent plus, if that is close enough for your purpose.

Mr. Wheat: You mean between 20 and 21 percent?

[fol. 8246] The Witness: Between 20 and 21 percent, yes.

Mr. Littman: As of December 31, 1941?

The Witness: As of December 31, 1941.

Mr. Wheat: Mr. Littman, just to be sure I know what the mathematics of this are—does that mean you took your figure of \$10,692,581.13 and divided that into \$2,240,000 to arrive at the 20 plus percent?

The Witness: Correct, yes, sir.

By Mr. Littman:

Q. The period over which the 89 percent total of dividends on common stock has been paid is six years, is it not?

A. It is five years and ten months, Mr. Littman.

Q. During this entire period, Michigan Gas Transmission Corporation has paid 6 percent per annum on its long-term debt, has it not? A. That is correct, yes, sir.

Q. And all of its long-term debt during this period was held and owned by the sole owner of its common stock, to wit, Columbia Gas & Electric Corporation, was it not?

A. That is my understanding.

[fol. 8247] FRED A. SPITZNAGLE a witness, having been previously duly sworn, resumed the stand and testified further as follows:

Cross Examination (Resumed)

By Mr. Littman:

Q. Mr. Spitznagle, you were going to calculate the net investment in gas plant, Michigan Gas Transmission Corporation, as of December 31, 1941. Are you now prepared to state the figure? A. Yes, I am.

Q. What is the net investment as of December 31, 1941?

A. As prepared from Exhibit 163 it is \$10,755,372.15, computed as follows: Long-term debt, \$8,320,500;

stated value of common stock, \$2,240,000;

Earned surplus, December 31, 1937, \$132,081.13;

Capital surplus representing earned surplus acquired, \$28,215.02;

Capital surplus donated—

Mr. Lee: (Interposing) What is that last word?

The Witness: Donated.

(Continuing) —\$139,500. The aggregate of the preceding amounts is \$10,860,296.15 from which has been deducted the intercompany profit previously described in the testimony of yesterday in the sum of \$104,924. The amount of \$104,924 is subject to reduction by depreciation accrued since June 30, 1941, which is approximately \$2,000 but which has not been applied in determining the amount of \$10,755,372.15.

[fol. 8249] Q. What you have done is to give me the gross over-all investment in the business of Michigan Gas Transmission Corporation as reflected by its balance sheet as of December 31, 1941, isn't that correct?

A. Well, I gave you just what I first stated. It is the long-term debt, capital stock and surplus of the Michigan Gas Transmission Corporation.

Q. That is the gross investment in the business, isn't it?

A. Adjusted for this item of \$104,924.

[fol. 8250] Q. Now, that amount is \$10,755,372.15?

A. That is correct.

Q. And was obtained in the manner which you have just described? A. That is correct, yes, sir.

Q. Now, will you please state the net investment in the gas plant as of December 31, 1941, which is the figure that I was seeking all the time?

Mr. Baldridge: As shown by the books?

By Mr. Littman:

Q. As shown by the company's books, yes, and reflected in Exhibit 163.

A. The net gas plant in service as of December 31, 1941, is \$10,929,098.47.

The Witness: Determined as follows:

Gas plant in service, \$12,804,341.16, from which I have deducted retirement reserve in the amount of \$1,697,965.73;

Contributions in aid of construction, \$9,352.96;

Net intercompany profit at June 30, 1941, in the amount of \$104,924, making total deductions of \$1,812,242.69.

The intercompany profit amount of \$104,924 is subject to reduction of about \$2,000, approximately.

By Mr. Littman:

[fol. 8251] Q. So that with the minor exception of the \$2,000 item which you just mentioned, the sum of \$10,992,098.47 represents the net investment in the gas plant of Michigan Gas Transmission Corporation as of December 31, 1941?

A. That is correct. I might add, net investment as determined from Exhibit 163, yes.

Q. Which exhibit is the financial statement of Michigan Gas Transmission Corporation for the year ended December 31, 1941? A. That is correct.

Q. Will you please turn to your Exhibit No. 92 entitled "Michigan Gas Transmission Corporation—Original Cost Depreciated to Present Condition as at June 30, 1941, and Observed Depreciation as at June 30, 1941"? Who originated the idea of presenting this exhibit, Mr. Spitznagle?

A. Well, I do not know as I recall who originated the idea of presenting the specific exhibit.

Q. Did you conceive of the idea?

A. It was discussed by myself and Mr. Green and I believe it was generally considered that an exhibit of this character should be presented in a rate case.

Q. You mean in a rate case or this rate case?

A. Well, this one, too, yes.

Q. Have you ever presented an exhibit like this in any other rate case?

[fol. 8252] A. I do not recall that I have, no.

Q. Do you recall of anyone else ever having presented an exhibit like this in a rate case?

A. No, sir, I do not. In fact, I have not attempted to find out whether anybody did or not.

Q. Well, do you accept responsibility for the presentation of this exhibit, not only with respect to the figures which are shown, but, also, with respect to the theory behind it?

A. No, not with respect to the theory behind the exhibit, if there is a theory behind the exhibit. I am responsible only for the proper expression of the original cost, the

amount shown in this statement and the computations resulting from the application of Mr. Haberly's percent condition.

Q. Well, that is what I wanted to determine, whether you were merely doing an accounting task of assembling the figures as shown? A. Primarily that.

Q. In Exhibit 92 that was primarily your undertaking?

A. That is right.

Q. You are not, then, expressing any view of your own with respect to Exhibit 92 as to the propriety of deducting the condition percents shown from the original cost?

A. No, sir.

[fol. 8253] Q. Well who is faking the responsibility for that, so that we may know whom to cross-examine?

A. Mr. Green, I presume.

Mr. Wheat: May I interpose a question there? This data that is shown on Exhibit 92 is data which can be obtained from other exhibits in the record, is it not? You state that it comes from certain exhibits there. All you did, as I understand your testimony, is to put it together on one sheet of paper?

The Witness: That is correct, yes, sir.

Mr. Wheat: Thank you.

By Mr. Littman:

Q. Does the sum of \$310,226.50, shown as the total of the column headed "Observed Depreciation", in your opinion represent all of the depreciation that has accrued to date on the original cost of the property of Michigan Gas Transmission Corporation?

A. Well, I have no opinion on that matter, Mr. Littman.

Q. You did a strictly mechanical job of assembling figures, is that right? A. I think I so stated, yes, sir.

Q. In your examination of the books and records of Michigan Gas Transmission Corporation, you found no such figure as \$310,226.50 representing any alleged depreciation, did you? A. No, sir, I did not.

[fol. 8254] Q. And when you prepared the balance sheet of the company for purposes of this proceeding, you did not set forth in that balance sheet what you have heretofore called the "true financial condition of the company" any such figure as \$310,226.50 for alleged depreciation, did you?

A. I think the balance sheet speaks for itself, but I did not, no, that is correct.

Q. We have been unable to find such a figure in your balance sheet and we thought perhaps you might refer us to it if such existed.

Well, we will go to the next exhibit and defer further cross-examination with respect to this exhibit to Mr. Green.

Q. Mr. Spitznagle, will you please turn to the next exhibit number which is No. 93 entitled "Michigan Gas Transmission Corporation, Statement of Contributions Made to Customers for Business Development for the Years 1936, 1937 and Five Months Ended May 31, 1938 (Effective Date of Natural Gas Act, June 21, 1938)"? Did you prepare this exhibit at the specific instance and request of someone else?

A. Yes, at the request of Mr. Green and others associated with him, Mr. Green primarily.

Q. Mr. Green is president of Central Service Corporation, which company is your employer?

A. That is correct.

Q. Now, let us look at item 1 on page 1 of this exhibit [fol. 8255] which relates to the Detroit City Gas Company "Contractual Discount Allowed Per Provisions of Article 7 of Gas Contract Dated March 17, 1936" in the amount of \$43,560. Will you amplify the description or characterization of this expenditure, inasmuch as the record thus far does not tell us very much about that payment or the reason for the payment?

[fol. 8256] The Witness: I was about to suggest, Mr. Littman, that I am not familiar enough with these contracts to give you or anybody else a very good interpretation of the reasons for paying these sums of money and I was going to further suggest that Mr. Young would be the man for you to get that information from.

By Mr. Littman:

Q. Can you advise us of the purpose of the payment of the \$43,560 to Detroit City Gas Company?

A. It is my understanding, generally, that the purpose of it was to assist somewhat in the change-over from artificial to natural gas.

Q: Do you know whether that was for the purpose of defraying certain expenses incurred by the Detroit City Gas Company in that connection as distinguished from the second item shown in Exhibit 93? Do you get my point?

A. No, I do not, Mr. Littman.

Q. I take it you are not familiar—

[fol. 8257] A. (Interposing) With the background of payments to give you a satisfactory answer, that is correct. I think Mr. Young would be far more able to do that for you.

Q. Do you know to what accounts these amounts were charged on the company's books?

A. Yes, sir, that I know.

Q. And what is the name of the account?

A. I cannot give you the designated account but it was charged to operating expenses.

Q. Would it refresh your recollection to say that these amounts, that is all of them shown on Exhibit 93 in the total amount of \$182,626.69 were charged to "Sales Promotion Expense"?

A. I do not recall. I did know at one time, but I do not recall right now, Mr. Littman, but they were charged to operating expenses. Whether it was to sales promotion expenses or a portion of it to general expense, I do not recall.

Q. Will you please turn to Page 30 of Exhibit 163? I show you an item in the amount of \$8,069.93 under the heading "Sales Promotion" on that page. Isn't it clear that the expenses of the character shown in Exhibit 93, which were incurred in the year 1941, were charged to that account?

Mr. Baldridge: Whose exhibit was that? Wasn't that a Panhandle Eastern exhibit?

Mr. Littman: 163 is the financial statement of Michigan [fol. 8258] Gas Transmission Corporation for the year ended December 31, 1941.

Mr. Baldridge: Oh, yes.

The Witness: I do not recall, Mr. Littman, that there were expenditures of the character detailed in Exhibit 93 incurred in the year 1941. I can ascertain the fact for you.

By Mr. Littman:

Q. I wish you would please ascertain and report to us whether it is a fact that all of the amounts shown in Exhibit 93, totaling \$182,626.69 were charged to the operating expense account, "Sales Promotion", on the books of the corporation.

In your opinion, Mr. Spitznagle, would the Federal Power Commission's Uniform System of Accounts permit the capitalization of this item or any of these items shown in Exhibit 93?

[fol. 8259] The Witness: I do not know what the Federal Power Commission has ruled with respect to items of this character, but in my opinion they might be includable under "Miscellaneous Intangible Plant" as representing a necessary expense in developing the business of the company.

By Mr. Littman:

Q. Well, are they now so carried on the books of the company? A. No, sir, they are not.

Q. Have they ever been so carried on the books of the company? A. No, sir, they have not.

Q. In your opinion, these amounts were properly charged by the company to sales promotion expense?

[fol. 8260] A. It was purely a matter of election on the part of the company as to whether they wished to treat them as miscellaneous intangible capital or whether they wanted to charge them to expense.

Q. And they elected to charge them to expense?

A. I so said before, yes, sir.

Q. Will you state the amount of sales promotion expense of a character similar to that set forth in Exhibit 93 which was incurred in the last seven months of 1938?

A. I am not in a position to do that, Mr. Littman. I do not have the information here, I can get it for you.

Q. Will you please furnish that information?

Or perhaps you had better let me read you the figures that we have and ask you to check them. It is our understanding that the following amounts were charged to sales promotion expense for the periods which I will name: The last seven months of 1938, which, incidentally, picks up where you left off in Exhibit 93, is \$29,000.46; for the full

year 1929, \$25,141.93; for 1940, \$4,019.71; and for the full year 1941, \$8,067.93.

Q. You will check those for me and report back later?

A. I will.

Q. What you propose to do now is to include in the rate base, for purposes of this proceeding, the amount of \$182,626 which has been charged in the past to operating expense?

[fol. 8261] A. I do not propose to do anything in that respect, Mr. Littman.

Q. Who does?

A. Well, Mr. Green is supporting the philosophy of the conclusions that were reached in this case with respect to our exhibits prepared for Michigan Gas Transmission Corporation.

Q. Do you have any opinion on the subject as to the propriety of including these past operating expenses in a rate base for rate making purposes? A. No, sir.

Q. We discuss that with Mr. Green, do we not?

A. That is correct.

Q. If you were making up a balance sheet of this company, would you permit this amount of \$182,626.69 to be restated on the books of the company and included in the capital accounts?

A. No, sir, and I have not in any of these statements included the item in any capital accounts, Mr. Littman.

Q. Have you been advised that the figures shown in Exhibit 93 are to be used in this proceeding as a basis for so-called going concern value?

Mr. Baldrige: May I make a slight correction? I do not think we use the term "going concern value", do we? I am asking you, Mr. Littman.

[fol. 8262] Mr. Littman: Well, I am asking this witness, Mr. Baldrige.

The Witness: In Exhibit 104 on Page 2, which I prepared, the items are included under the caption "Rate Base" and denominated "Cost of Developing Business."

By Mr. Littman:

Q. Have you ever heard this item referred to by any other name? A. No, sir, I have not.

Q. You know, do you not, that it is very similar to amounts which have been designated in rate making proceedings as "Going Concern Value"?

A. Yes, it is one of the elements that sometimes is included in the computation of going concern value.

Q. I take it from your testimony with respect to Exhibit 93 that you do not take any responsibility for the inclusion of these figures in any suggested rate base for the purpose of this proceeding? A. No, sir.

Q. What instructions did you have, if any, with respect to securing these figures from the company's books?

A. Well, I was requested to secure the cost of developing business, particularly items of the nature described in the exhibit, and we did take the items in question from the company's books and I was instructed to include in the computation shown in Exhibit 104 the amounts shown in Exhibit 93.

[fol. 8263] Q. In other words, you did a mechanical job of accounting here. A. That is correct, yes, sir.

Q. We will now go to Exhibit No. 94 entitled, "Michigan Gas Transmission Corporation—Working Capital—as at June 30, 1941."

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Trial Examiner: Very well.

By Mr. Littman:

Q. Suppose you tell us what responsibility you are taking with respect to this exhibit which shows a claimed working capital as of June 30, 1941, of \$300,147.08?

A. I am taking no responsibility for the use of the item in connection with the conclusions reached in the matter of rate base and rate of return and any other matters reached in the conclusion presented in Exhibit 104 and presented in Mr. Green's testimony in connection with Exhibit No. 104.

Q. Mr. Green will take the responsibility on Exhibit No. 94? A. Not entirely.

Q. Suppose you state the instructions that you received so that we may be advised of what you did and what you are holding yourself responsible for?

A. The instructions I received were to prepare Page 2 of Exhibit 94 and it was more or less my recommendation

that the exclusions made on that exhibit from operating expenses should be made in order to determine the net for the cash fund computation.

Q. What of the other pages? A. Let's finish this one.

Q. I am sorry, I thought you had.

A. With respect to the computations shown in the last three lines of Page 2, I was instructed to use 45 days as the lag in recovery of the operating expenses shown in this exhibit. I was told that that was the period generally accepted by the Commission in many of its cases.

Q. Who told you that? A. I beg your pardon?

Q. Who told you that?

A. Mr. Green or someone in our organization working with him. I think Mr. Green told me. I also ascertained that fact by looking at a few cases of the Federal Power Commission as well, Mr. Littman.

Q. You verified the matter? A. That is right.

Q. By the way, none of those cases were related to [fol. 8265] Michigan Gas Transmission Corporation?

A. No, that is true. They were previously decided cases of the Commission. I have forgotten where they were, I believe 45 days was used in the Chicago Pipeline case or the case that is known as the Chicago Pipeline Case.

For Page 3 of that exhibit, I was told to gather the information shown on that exhibit and when the information shown on the exhibit was brought to Mr. Green's attention and to the attention of Michigan Gas Transmission Corporation, it was decided by Mr. Green that we should use the material and supplies on hand adjusted for the year amount shown in Column B at June 30, 1941, rather than the average for the 18-month period shown in this statement.

Q. And that decision was made by Mr. Green?

A. Yes, that is right, because the advent of the war was making it necessary to maintain a larger quantity of material and supplies on hand than formerly was thought necessary. I think I so stated in my direct testimony.

Q. This looks like a kind of "triple pass," doesn't it? That is, Mr. Green told you to get the actual figures from the company's books as of June 30, 1941, after you had

shown him the figures for each of the 12 months for the year 1940 and for the six months in 1941 and then Mr. Haberly was instructed to revise the prices on certain of those materials and supplies to June 30, 1941, and they [fol. 8266] came back to you and you included the total amount of \$100,723.78 in Exhibit 94. Is that right?

A. I do not think that is quite right. I do not understand your language entirely, especially the "triple pass" and that sort of thing in the first part of your statement.

The fact of the matter is I was told to get the factual information represented by Column A for the 18-months' period.

Q. Just a moment. You did not use any of the figures in Column A in connection with your Exhibit 94, did you?

A. Only in arriving at the amount that we did use in Exhibit 164.

Q. Somebody got hold of it before you put the \$100,723.78 in, isn't that right? A. That is right.

Q. And that was Mr. Haberly?

A. No, I doubt whether Mr. Haberly ever saw the figures in Column A prior to his determination of the amount expressed in Column B.

Q. Whether he saw it or not, when he got through it went up to \$100,723.78, isn't that right? A. It did do that.

Q. And then you took it and put it on the first page of Exhibit 94? A. That is right.

Q. That is what I meant by "triple pass."

[fol. 8267] A. That is right.

Q. At any rate, you are not taking any responsibility in connection with the reasons or theories behind the readjustment of the figures?

A. I just gave you what I understood to be the reason but I am not taking the responsibility for it.

Q. Are there any other pages of Exhibit 94, Mr. Spitznagle, that you wish to elucidate for us with respect to your particular assignment? How about Page No. 4?

A. Page No. 4, again, I was requested to get the factual information displayed on that page and I was directed to use the amount shown on Exhibit 94 in the compilation shown on Page 1.

Q. You exercised no judgment of your own in assembling those figures other than to take them from the company's books? A. That is all.

Q. Very well. Let's turn to Page 2 of Exhibit 94. You have just testified that you decided to make the deductions shown on that page entitled "Purchased Gas," "Taxes," "Pre-payments included in operation and maintenance," "Depreciation or amortization," isn't that correct?

A. I suggested that those items be excluded, yes.

Q. And your suggestion was accepted by Mr. Green?

A. That is right.

Q. Why did you exclude the purchase gas expense? [fol. 8268] A. For the reason that I found upon examination of the company's records that they collected for the sale of their gas and services, because they are a transportation company at about the same time they paid for the natural gas that they purchased.

Q. In other words, you made the deduction and did not include purchased gas expense in working capital because you found there was no lag between the date of payment and the day of receipt of revenue? A. That is correct.

Q. And of course, that is a proper deduction, isn't it?

A. I think so.

Q. We think so too. We wish Mr. Sperry had done that.

Trial Examiner: Upon examination of the Order of the War Production Board presented by Mr. Baldrige this morning, it appears that this Order probably should be incorporated into the record in some manner.

I wish to ask whether the document from which this photostatic copy was made was an original document?

Mr. Baldrige: Yes, Mr. Examiner.

[fol. 8269] Trial Examiner: In any event, this photostatic reproduction presents an original order issued to the Panhandle Eastern Pipe Line Company by the War Production Board?

Mr. Littman: Wouldn't it be a little more accurate to say this order was not issued directly to Panhandle Eastern Pipe Line Company but was issued as a general order [fol. 8270] affecting all companies referred to?

Trial Examiner: In accordance with the statement made this morning, this order has now been examined and is deemed in all respect proper and necessary for the record and will, therefore, be extended by the reporter into the record.

[fol. 8272] Title 32—National Defense WPB 230

24033 Chapter IX—War Production Board

Subchapter B—Division of Industry Operations

Part 1056—Natural Gas

Limitation Order L-31

To Curtail Consumption of Natural Gas.

Whereas, because of increased gas requirements for war production and civilian uses, and because of scarcity of materials for the construction of pipe lines and other facilities, shortages of natural gas have occurred in certain areas of the United States and are threatened on others, and

Whereas, during periods of adverse weather conditions, the demand for natural gas in many areas will increase beyond the capacity of existing facilities to meet such demand; and

Whereas, the limitations upon deliveries of natural gas and the integration of gas system operations hereinafter ordered are necessary in order to maintain gas deliveries to war industries and essential civilian services;

Now, Therefore, It Is Ordered That:—

Part 1056.1—General Limitation Order

(a) Definitions. For the purpose of this Order:

(1) "Persons" means any individual, partnership, association, business trust, corporation, governmental corporation, or any organized group of persons whether incorporated or not.

(2) "Utility" means any person in the United States supplying natural gas or mixed natural and manufactured gas, directly or indirectly, for general use by the public.

(3) "Consumer" means an ultimate user of gas purchased or otherwise received from any Utility.

(4) "Standby Facilities" means equipment in serviceable operating condition designed to use oil, electricity, coal or other fuel to replace natural gas, and for the operation of which a supply of such fuel is available.

(b) Integration of Gas System Operation. Each Utility shall so operate its gas manufacturing, transmission, storage, distribution, and other facilities, and shall so interchange gas with other Utilities as to achieve as far as practicable maximum output in the area or areas in which a shortage exists or is imminent, and each Utility shall make such pooling arrangements as may be necessary to effectuate such purpose. Where necessary for such purpose, the Director of Industry Operations will, from time to time, issue specific directions as to the operation of gas manufacturing, transmission, storage, distribution, and other facilities, and as to deliveries of gas.

(c) Limitation on Deliveries of Natural or Mixed Natural and Manufactured Gas.

(1) In the event that the supply of natural or mixed [fol. 8274] natural and manufactured gas available in an area served by any Utility is insufficient to meet the demand therefore, and reduction in deliveries to Consumers becomes necessary, the Utility supplying such area shall reduce deliveries to its Consumers in the following manner and in accordance with such other specific directions as the Director of Industry Operations may from time to time issue:

(i) First, the Utility shall, within the limits of its contractual rights, reduce deliveries to all dump or surplus Consumers not engaged in war production; and deliveries

to Consumers who have Standby Facilities, the operation of which can directly or indirectly reduce the total demand for natural or mixed natural and manufactured gas in the area.

(ii) Second, the Utility shall to the extent necessary, operate all of its available gas manufacturing equipment so as to effect directly or indirectly the maximum increase in the supply of gas in the area.

(iii) Third, the Utility shall, without regard to its contractual rights or those of any Consumer, reduce deliveries to all other Consumers who have Standby Facilities to the extent that the operation of such facilities can directly or indirectly alleviate the shortage of natural or mixed natural and manufactured gas in the area, and no such Consumer, after notification of the reduction in deliveries required shall accept deliveries of gas unless his [Vol. 8275] Standby Facilities are being operated so as to effect the required reduction in his purchase of gas.

(iv) Fourth, the Utility shall, without regard to its contractual rights or those of any Consumer, reduce as far as practicable deliveries to Consumers in such manner as will cause the least interference with war production, and each Consumer who receives notification of the reduction in deliveries required shall reduce his acceptance of deliveries accordingly.

(2) Whenever any Utility finds it necessary to make any reduction in deliveries of gas to any Consumer in accordance with paragraphs (c) (1) (iii) and (c) (1) (iv) of this Order, it shall promptly notify the Consumer and at the same time give telegraphic notice thereof, to the Power Branch, War Production Board.

(3) Following each such shortage period, each affected Utility shall submit a detailed report of the quantities of gas conserved by the operation of Standby Facilities and the duration of curtailment and the extent to which each industrial Consumer was curtailed. Such report shall be filed on Form PD-283.

(4) Any consumer who considers that any reduction in deliveries to him interferes materially with war production shall have the right to apply by telegram for relief

to the Director of Industry Operation, who may grant such [fol. 8276] specific exemptions or take such other action as may be consistent with the purposes of this Order. Such application shall state the nature of the war materials being manufactured, the extent to which production has been curtailed because of reduced delivery of gas, and the increase in delivery of gas required for restoration of full production.

(5) No consumer shall be relieved of the requirements of section 944.2 or any other section of Priorities Regulation No. 1 Amended, by reason of the provisions of this paragraph (c). (d) Restrictions upon Increased Deliveries to Non-residential Consumers. No Utility shall, after ten days following the effective date of this Order, deliver natural or mixed natural and manufactured gas to any new non-residential Consumer in the areas specified in Exhibit "A" annexed hereto, as the same may be amended from time to time, or increase deliveries of such gas to any existing non-residential Consumer in such areas for the operation of any new gas equipment, unless:

(1) Such new existing non-residential Consumer shall have installed, prior to the date of the increase in deliveries, Standby Facilities of sufficient capacity to replace the new or increased deliveries of such gas during periods of shutoff, or

(2) Such new or existing non-residential Consumer cannot reasonably use any fuel other than gas, natural, or mixed natural and manufactured, because of technical utilization factors or process requirements.

[fol. 8277] (3) Such new delivery or increase in deliveries shall have been specifically approved in advance by the Director of Industry Operations. Any Consumer or Utility who considers that such deliveries are necessary for war production may apply for such approval to the Director of Industry Operations, who may grant such specific exemptions or take such other action as may be consistent with the purpose of this Order. (e) Prohibition against Delivery to New Space Heating Installations.

(1) No Utility shall deliver and no Consumer shall accept delivery of natural gas or mixed natural and manufactured gas in the areas specified in Exhibit "A" annexed hereto; as the same may be amended or modified from time to time by the Director of Industry Operations, for either of the following purposes:

(i) for the operation of central space heating equipment (or for heating requirements of the premises), unless such equipment was installed prior to March 1, 1942, or unless, in the case of new construction, the equipment was specified in the construction contract, and the foundation under the main part of the structure in which the equipment is to be installed was completed prior to March 1, 1942; or

(ii) for the operation of central space heating equipment for (or heating equipment supplying the major portion of the heat requirements of the premises), which has [fol. 8278] been converted from other fuel to natural or mixed natural and manufactured gas unless such conversions has been completed prior to ten days after the effective date of this Order.

(2) Any Utility affected by the provisions of this paragraph (e) or any governmental agency which considers that supply of gas available on any particular system or portion thereof is adequate to take care of all existing and estimated future requirements of war industry, and unrestricted civilian use for the period ending April 1, 1944, may apply for exemption of the system or any portion thereof from the provisions of this paragraph to the Director of Industry Operations, who may grant such specific exemptions or take such other action as may be consistent with the purposes of this Order.

(f) Appeal. Any person affected by this Order who considers that compliance therewith would work an exceptional and unreasonable hardship on him may appeal for relief to the Director of Industry Operations, who may grant such specific exemptions or take such other action as may be consistent with the purposes of this Order.

(g) Reports and Information.

(1) Each Utility shall keep and preserve for not less than two years accurate and complete records concerning deliveries of natural gas to Consumers.

(2) Such records shall be subject to inspection by duly [fol. 8279] authorized representatives of the War Production Board.

(2) All persons affected by this Order shall execute and file with the War Production Board such reports and questionnaires as said Board shall, from time to time, request. (h) Communications to War Production Board. All reports required to be filed hereunder, and all communications concerning this Order, shall, unless otherwise directed, be addressed to:

“War Production Board

Washington, D. C. Ref.: L-31”

(i) Violations. Any persons who wilfully violates any provisions of this Order, or any other order, direction or regulation, issued pursuant hereto, or who by any act or omission falsifies records to be kept or information to be furnished pursuant to this Order, may be prohibited from delivering or receiving gas, or any other material subject to allocation, and such further action may be taken as is deemed appropriate, including a recommendation for prosecution under Section 35(A) of the Criminal Code (18 USC. 80).

(j) Effective Date. This Order shall take effect immediately and, unless sooner terminated, shall continue in full force and effect until April 1, 1943.

(P.D. Reg. 1 Amended, Dec. 23, 1941, 6 F.R. 8680; W.P.B. Reg. 1, Jan. 26, 1942, 7 F.R. 561; E.O. 9024, Jan. [fol. 8280] 16, 1942, 7 F.R. 329; E. O. 9040, Jan. 24, 1942, 7 F.R.; sec. 2 (a), Public No. 671, 76th Congress, Third

Session, as amended by Public No. 89, 77th Congress, First Session.)

Issued this 16th day of February, 1942.

J. S. KNOWLSON,

Director of Industry Operations.

Exhibit A

Areas subject to prohibitions contained in paragraph (e) of Limitation.

Order L-31

Alabama—(except the area served by the United Gas Pipe Line Company)

Arkansas—(only the area served by the Mississippi River Fuel Company)

California—District of Columbia—Georgia—Illinois—Indiana—Kentucky—Maryland—Michigan—Mississippi—(except the area served by the United Gas Pipe Line Company)

Missouri—New York—Ohio—Pennsylvania—Tennessee—Virginia—West Virginia.

[fol. 8284] Trial Examiner: Proceed, Mr. Littman.

By Mr. Littman:

Q. Will you please refer to the 1941 financial statement of Michigan Gas Transmission Corporation which has been identified as Exhibit No. 163 and state whether the operating and maintenance expenses, exclusive of gas purchase cost, taxes and depreciation, amounted to \$417,848 for the year ended December 31, 1941?

A. Mr. Littman, don't you think it might be well for you to give me the figures that you used and where you located them?

Mr. Littman: Yes, I think I could do that. The figures which go to make up the amount of \$417,848 are shown on Page 4-B of Exhibit 163.

Mr. Wheat: Do they appear on that page as a single figure at any place, Mr. Littman?

Mr. Littman: I had not completed my explanation.

Mr. Wheat: Pardon me.

By Mr. Littman:

Q. The total operating expenses shown for the full year 1941 on that page amount to \$4,506,302.99, do they not? A. Yes, sir.

Q. Following the method that you have used to arrive at the sums called "Net for cash fund computation" shown on Page 2 of your Exhibit 94, we first deduct "gas pur-[fol. 8282] chased—others" in the amount of \$3,249,178.39. Do you find that? A. I do, yes, sir.

Q. We then deduct the item shown on Page 4 of Exhibit 163 called "Taxes—Federal" in the amount of \$329,837.20. Do you find that? A. Yes, sir.

Q. And also there is deducted the State taxes as shown in the amount of \$142,655.06. Do you find that?

A. Yes, sir.

Q. Then a deduction is made for depreciation called "Provision for retirements & depletion" in the amount of \$366,785.40? A. I find that item, yes, sir.

Q. Now, after those deductions are made, there is a total produced of \$417,848. Is that right?

A. \$417,854.94, I believe.

Q. Yes, the difference is probably because we dropped the pennies in our calculation. A. Yes.

Q. Now, that figure which you have just read of \$417,000-odd is comparable, is it not, to the sum of \$349,301.30 shown on Page 2 of your Exhibit 94 for the year ended June 30, 1941 called "Net for cash fund computation," is it not?

A. With one exception. You have not excluded in your latter figure the prepayments that were included in our [fol. 8283] operating expenses.

Q. Suppose you deduct those.

A. That is impossible because it would be a very meticulous computation and the amount is not very large.

Q. It would not affect—

A. (Interposing) Not materially, no, Mr. Littman.

Q. All right. You understand what we are seeking to do now is to apply your method to get the figure for the year ended December 31, 1941? A. Yes, sir.

Q. Now, in order to get the amount comparable to that which you allow for cash funds for operating expenses, we must take 45/365 of the \$417,800-odd figure, do we not? A. Yes, that is correct.

Q. And what is the result of that? We get \$51,520, is that about right?

A. That is approximately correct, Mr. Littman.

Q. In other words, if the Commission were to take the company's book figures for the full year, 1941, rather than for the period which you used ended June 30, 1941, the result would be \$51,520 as compared with the figure which you have used?

A. Approximately that amount, Mr. Littman. I have not completed the computation. I simply roughed it off and know it would be in the neighborhood of \$50,000.

[fol. 8284] Q. And that is comparable to your figure of \$447,175.05 "Cash fund operating expenses" shown on Page 1 of Exhibit 94? A. That is correct, yes, sir.

Q. In other words, a slightly higher figure would result? A. Yes, sir.

Q. Now, the next item which you show on Page 1 of your Exhibit 94 for working capital is an item of \$100,723.78 for materials and supplies. What was the actual amount of materials and supplies on hand at June 30, 1941, as shown on the company's books?

A. The amount was \$93,412.78.

Q. Now, Mr. Haberly repriced certain of the materials and supplies which resulted in an upward revision of that figure to the extent of \$7,311, did he not? A. That is correct.

Q. Making the total which you have used on Page 1 of your Exhibit 94 \$100,723.78? A. That is correct, yes, sir.

Q. What was the amount of materials and supplies on hand at December 31, 1944, as shown by the company's books?

A. Shown by the company's books and as reported on Page 1 of Exhibit 163, Line 53, the amount of materials and supplies on hand was \$115,053.90.

Q. Do you know the average monthly inventory of materials and supplies for the full year 1941?

[fol. 8285] A. No, sir, I do not.

Q. I shall read you a figure which we have computed to represent the average monthly inventory of materials and supplies for the full year 1941 as reflected by the company's books and will ask you to check it. The figure which we secure is \$93,768. This figure was arrived at by totaling the inventory, as shown by the books of the company, as of the end of each of the 12 months in the year 1941 and dividing by 12. Will you check that figure?

A. Yes, sir, I will.

Q. Perhaps we had better put it this way, Mr. Spitznagle, if there is no objection, suppose you accept the accuracy of these figures that I have been reading, unless you report back to the contrary. I think it would make for a better record. You check these figures and if you find any inaccuracies, please state them on the record.

A. Very well.

Mr. Baldridge: I think, Mr. Littman, to make the record complete in that respect he ought to state definitely whether he finds those figures to be accurate.

By Mr. Littman:

Q. All right.

Q. You are keeping a list of these as we go along?

A. Yes, sir.

Q. Do you know the total of supplies and materials [fol. 8286] issued during the 1941?

A. No, sir, I do not.

Q. The figure which we calculate is \$43,390. This figure was calculated by totaling the monthly issues during the entire year 1941, as shown on the company's 1941 financial statement, Exhibit No. 163. I should correct my statement, to the extent that the monthly figures were used they were taken from the company's books?

A. I think that is true, I do not think they appear in Exhibit 163 or in their financial report.

Q. That is right, the Exhibit No. 163 shows the figure for only one month, namely, December 1941. Is that right?

A. That is right, yes.

Q. Now, assuming the accuracy of the figures which I have just given, it is a fact, is it not, that the average monthly inventory of materials and supplies on hand dur-

ing the year 1941 was more than twice the amount actually issued and used during that year. Isn't that correct?

A. Yes, that is true.

Q. In other words, if the computations which we have made are correct, it appears that the company had a two-year supply on hand on the basis of the 1941 supply and use, isn't that right?

A. No, I do not think that is a proper deduction. The company actually has on hand a great deal of pipe and [fol. 8287] compressor parts and what not that do not turn over, as I have indicated.

Q. Well, I am speaking of an average term.

A. Well, you can call it on the basis of the figures you are using, a turnover of two, but I do not believe it is such, I think it is less than that.

Q. What investigation have you made of that matter, if any?

A. I examined the detail of the inventory account and ascertained the fact that the company was in the habit of carrying pipe replacements for future eventualities in their inventory account and more or less large items of replacements for compressor stations and that type of equipment.

Mr. Young, I believe, in direct testimony testified to the need of that practice and of following that procedure.

Q. What you are saying is that some of these materials and supplies are turned over more rapidly than others?

A. Or at a much lesser rate rather than more rapidly.

Q. Well, to state it conversely.

A. Well, that is true, some would be at a more rapid rate and some at a lesser rate.

Q. Well, but looking at the average of the materials and supplies, assuming the accuracy of the figures, the average monthly inventory of materials and supplies on hand during the year 1941 was on the average more than [fol. 8288] twice the amount actually used during that year?

A. Assuming the figures that you used, that is correct, yes. I might add, I do not think that a factor of that character is indicative of the amount of materials and supplies that are to be carried on hand.

Q. Are you expressing an opinion as to the amount of materials and supplies required to be on hand?

A. No, I simply expressed an opinion as to that factor indicating how much materials and supplies should be carried on hand. I do not know how many should be carried on hand. Mr. Young testified to the dollar amount and the quantities that should be carried on hand.

Q. You are not testifying that \$100,723.78 is the amount that is actually required?

Mr. Baldrige: May I interject a question?

Mr. Littman: Yes, sir.

Mr. Baldrige: Do you happen to know how much materials and supplies are carried on hand at the present time?

The Witness: No, sir, I do not.

By Mr. Littman:

Q. And the next item which you show in Exhibit 94 is the amount of \$116,303 for "Minimum Bank Balances Required to Support Check Privileges Based Upon Advice Received from Depositories." Will you please refer to Page 21-B of the 1941 financial statement of Michigan Gas [fol. 8289] Transmission Corporation, which is Exhibit No. 163? Will you state the amount that has been accrued by the company for Federal income taxes to December 31, 1941? A. \$268,384.85.

Q. That money is in the bank, isn't it, or at least it was in the bank at December 31, 1941, was it not?

A. The company had funds in the bank in excess of that sum of money.

Q. And \$268,384.85 of the amount which the company had in the bank was expressly for the purpose of paying Federal income taxes?

A. It was usable for that purpose, Mr. Littman, but it was not expressly for the purpose of the income taxes. In other words, you are asking me to match up dollars and I simply cannot do it for you.

Q. That amount was accrued for payment of Federal income tax?

A. That was accrued from the operations, there was cash on hand in the bank of the amount stated in this exhibit.

Q. Will you give us the total amount of cash in the bank at December 31, 1941?

A. Excluding working funds, the amount of cash on hand at December 31, 1941, as shown in Exhibit 163, is \$172,585.11.

Q. When will the sum of \$268,384 which has been accrued for Federal income taxes to December 31, 1941, be paid?

[fol. 8290] A. Well, it is payable March 15 or in quarterly installments starting from March 15, 1941, upon the election of the company. 1942, I beg your pardon.

Q. And what has the company elected to do in this regard in the past, to pay it all at once or to pay it in four installments through the year?

A. I cannot tell you that right offhand.

Q. What would you suggest that the company do in that regard?

A. Well, if the company had the money, because of the general conditions of the country, I would suggest that they pay it all on March 15, 1942. If they haven't the money I suggest they pay it in quarterly installments.

Mr. Goodman: You would give me the same advice, wouldn't you?

The Witness: I would. I am taking it myself, likewise.

By Mr. Littman:

Q. Our investigation shows, Mr. Spitznagle, that the company has followed the practice of making its income tax payments on the quarterly installment plan, as I think is true of most of us, but I want you to check that and report back. Perhaps Mr. Young—

A. (Interposing) Why not ask Mr. Young now?

Mr. Littman: Do you know?

Mr. Young: On a quarterly basis, I understand. I would [fol. 8291] like to check that, however, and see if it is true.

By Mr. Littman:

Q. Will you report back so that the record may be clear? A. Yes.

Q. As a matter of fact, hasn't the company followed a consistent policy of accruing more taxes than it actually has been required to pay in the past?

A. Yes, sir, that is true, however, the additional accrual is not reflected in the amount of taxes that you asked me to quote from Page 21-B of Exhibit 163.

Q. You mean it is not included in the amount of \$268,384.85?

A. That is correct, yes, sir.

Q. What amount had the company accrued for Indiana 1941 property taxes as of December 31, 1941?

A. \$114,000.

Q. And when will this be paid?

A. I do not believe I have, Mr. Littman, the payment dates of the Indiana property taxes.

Mr. Littman: Mr. Young, we ask you whether you can furnish us with some of those figures.

Mr. Young: Will you repeat that please?

Mr. Littman: We would like to know when the Indiana property taxes for the year 1941 will be payable?

Mr. Young: I cannot tell you that.

[fol. 8292] By Mr. Littman:

Q. Of course, Mr. Spitznagle, neither the Federal income taxes nor the Indiana property taxes which had been accrued to December 31, 1941, are payable until sometime during the year 1942? A. That is correct, yes, sir.

Mr. Wheat: Mr. Littman, the local property taxes are usually on a July 1 to 30 basis, I think, in most states and of course, whether they are in Indiana I do not know, therefore, the payments come at odd times, usually April and December, but I am not certain about Indiana, of course.

By Mr. Littman:

Q. It is a fact, is it not, that at the end of the year 1941 the company had accrued \$114,000 for the Indiana property taxes? A. That is correct, yes, sir.

Q. Will you please ascertain for us the facts with respect to how these taxes are paid?

A. Yes, sir. I might add that property taxes in the various States vary greatly. I think I know when Indiana property tax is payable but I am not sure because I have not had occasion to check it recently.

Q. Of course, the amounts required for the payment of the 1941 taxes have already been collected from the customers, have they not?

[fol. 8293] A. That is on the assumption that the company has earned the taxes as well as all the other expenses and it appears that they have.

Q. Well, the income statement shows that they have, is that right? A. That is correct.

Q. And it shows that the company paid a 29 percent dividend on its common stock in 1941?

A. Not out of 1941 operations, Mr. Littman.

Q. Of course, Mr. Spitznagle, these accruals of taxes provide for more than enough cash to cover the minimum bank balance of \$116,000, do they not? A. They do, yes, sir.

Q. What was the actual net working capital of Michigan Gas Transmission Corporation as of December 31, 1941?

Mr. Baldridge: As defined how?

Mr. Littman: As defined in the Accountant's Handbook and as defined by Mr. Coffman.

Mr. Baldridge: And previously referred to by Mr. Spitznagle in the terms used yesterday.

Mr. Littman: Yes.

The Witness: Well, I do not know what Mr. Coffman's definition is.

By Mr. Littman:

Q. Well, his is the same as the Handbook?

[fol. 8294] A. I can tell you what the net current assets are as shown in this balance sheet and I will be glad to give it to you.

Q. I beg pardon?

A. Net current assets, I can give you that figure, sometimes referred to as "Net working capital."

Q. Well, that is the figure we want as of December 31, 1941.

A. Yes. The amount is \$58,762.87 determined as follows from the financial report, Exhibit 163, of Michigan Gas Transmission Corporation:

Current assets, \$1,533,085.82;

Intercompany accounts receivable not included in current assets but which are of a current asset nature and are collected for currently, \$29,323.77;

Current liabilities, \$1,495,780.03;

Intercompany accounts payable which are for current liabilities and are paid currently, \$7,866.69.

Q. Now, Mr. Baldridge, as you have observed, asked me to clarify and define the use of this term "Actual working capital." You have defined it, have you not?

A. I think I have as it is generally used, generally accepted.

Q. Now, is such a figure proper for rate making purposes, in your opinion, for working capital?

[fol. 8295] A. I have not any opinion on the subject, that is a matter for the Commission to determine what is proper. I have known cases where the net current assets were not a consideration in determining working capital at all.

Q. Well, the figure for working capital shown in your Exhibit No. 94 is \$300,147.08, is it not? A. That is correct.

Q. Did you register any disagreement with Mr. Green when you presented this figure to him? A. Not at all.

Q. Of course, if you want to accept the \$58,000 figure of actual net working capital arrived at in the manner which you have described it, there will be no objection. You make no such suggestion, do you?

A. I am not either accepting or giving in the matter of what is to be working capital, Mr. Littman.

Mr. Baldridge: As counsel of Michigan Gas Transmission Corporation I can assure you that we do not accept that \$58,000 figure as being adequate.

Mr. Littman: In this proceeding?

Mr. Baldridge: Or any other similar proceeding.

Mr. Littman: I take it you ~~do~~ not propose to offer Mr. Coffman as a witness in this proceeding?

Mr. Baldrige: All we have done with respect to Mr. Coffman's testimony is to say that he presented certain [fol. 8296] statistical data which, to some extent, may prove the basis of some of the testimony presented on behalf of Michigan Gas Transmission Corporation.

Mr. Littman: You are referring to the data used by Mr. Drew in connection with his testimony?

Mr. Baldrige: Primarily Exhibits 63 and 64, as I recall it.

Mr. Littman: But not Exhibit 65?

Mr. Baldrige: Well, Exhibit 65 may have some statistical data which might be appropriate, but as I recall it, Mr. Drew testified that he had not even seen Exhibit 65 when he presented his testimony.

Mr. Littman: Well, it is Exhibit 65 that contains Mr. Coffman's estimate of so-called "working capital."

By Mr. Littman:

Q. Mr. Spitznagle, will you please turn to Exhibit No. 96 entitled "Estimated Annual Amortization, Short Lived Property—24 and one-half Year Amortization Period" for Michigan Gas Transmission Corporation? Is it your testimony that the sum of \$7,802.08 will be required annually to amortize the short-lived property shown on Exhibit 98?

A. Yes, sir. Since I made the computations on this statement, I am charged with the responsibility of the results shown on the statement.

Q. This is one exhibit for which you take the full [fol. 8297] responsibility?

A. I take responsibility for the computation, Mr. Littman, yes, as it is explained at the bottom and running across the face of the page. The factors that I have used with respect to original cost are my responsibility, the determination of percent condition and salvage is Mr. Haberly's responsibility.

Q. Well, was this exhibit your idea?

A. The average life of equipment is Mr. Haberly's responsibility. The philosophy behind the exhibit, I think, is Mr. Green's.

Q. You are not taking any responsibility with respect to the propriety of the method set forth in Exhibit 98 of amortizing the short-lived property there shown? A. No. [fol. 8298] Q. You understand, do you not, that the method used by Mr. Haberly to depreciate this property to June 30, 1941, which is reflected in column B headed, "Percent condition including salvage" was the so-called observation method?

A. I heard him testify to that fact, yes, sir.

Q. Well, at any rate, it was not the utilization of a straight line life method, was it?

A. I was under the impression when the statement was made up that he had so determined it on a straight line basis plus salvage. However, he testified here yesterday that he determined the amount on an observed depreciation basis.

Q. I had the same difficulty but, at any rate, his testimony is now a matter of record and you understand it as you have just stated? A. That is correct, yes, sir.

Q. Now, that means that we have one method used to arrive at the percent condition at June 30, 1941, namely, the observation method and from there on, we have a new method by which to depreciate it, do we not, or I should say a different method?

A. A different method of calculation, yes, calculating the amount of depreciation responsive to the short-term property.

Q. That is, before June 30, 1941, it is the observation method and after June 30, 1941, it is the straight line [fol. 8299] life method, is it not?

A. No, it is an amortization method, assuming that the property will have to be replaced a certain number of times during the period then applying the 25 years' finite life which was adopted in this presentation, we arrive at the average amount that would be required each year—I misspoke myself as to the 25-year period—it is 24½ years.

Mr. Baldridge: From June 30, 1941?

The Witness: From June 30, 1941.

By Mr. Littman:

Q. You mean the property is amortized in Exhibit No. 98 on the straight line basis?

A. Figuratively speaking, yes, that is true.

Q. What is figurative about my statement? I mean, what is wrong with my statement?

A. Well, you might consider that you would apply the theory of discounting the annual amortization of short-term property in the same manner that you discounted the annual amortization on the straight line basis for the long-term property. In the case of the short-term property, the funds will be used at short intervals and there is no point in amortizing them.

In other words, you do not have any use of that money between the time it is recovered and the time it is required for renewals and replacements.

[fol. 8300] Q. What method does the company use to depreciate this property? A. Straight line method.

Q. Did the company use the observation method of depreciating this property on its books prior to June 30, 1941? A. It did not.

Q. In your opinion, has the company depreciated this property in an improper manner on its books prior to June 30, 1941?

A. I have not any opinion. I see nothing wrong about the manner in which they did it. As to the amount, I haven't any opinion as to whether they fully depreciated the property or whether they did not fully depreciate it in accordance with what experience they might have had.

Q. You believe the company handled it properly, do you not?

A. Well, I have no quarrel with the way they handled it, Mr. Littman, if that is what you mean. Whether they fully recovered the amount which should have been recovered, I do not know. I haven't any idea.

Q. I cannot understand why it is necessary, for purposes of this proceeding, to deviate from the practices of the company in regard to setting up depreciation and I want you to enlighten me, if you can. Why is it necessary?

A. I do not know actually why it is necessary to [fol. 8301] deviate except to attempt to recover the dol-

lars that are invested in the property to be used during the 24½ year life. That is the only object I would know for asking for amortization or depreciation or any other factor.

Q. Isn't that precisely what the company is doing by the present method?

A. They are making a provision. Whether it will recover the property over a 24½ year life or their investment in the property, I do not know. I might add that I do know they are using for the major portion of the property a depreciation rate of 3 percent which infers a straight line period of 33½ years.

Q. Not on transportation equipment?

A. No, not on that.

Q. The transportation equipment makes up the largest portion of the short-term property? A. That is correct.

Q. And the same is true of furniture and fixtures, isn't that right?

A. That is true. You have an exhibit in evidence that gives you that information specifically.

Q. You mean Exhibit No. 99, Page 3? A. Yes, sir.

[fol. 8302] The Examiner: Let's go forward.

By Mr. Littman:

Q. Before the recess, you made a reference to Page 3 of Exhibit 99 and you were going to tell us something about the manner in which the company has been depreciating the short-lived property shown in Exhibit 98. Will you proceed to advise us as to this company's own method?

A. I do not find that the Exhibit 99 to which you refer and to which I alluded, shows the depreciation rate for anything but all items of property except automotive equipment and any transportation equipment and special equipment.

Transportation equipment is depreciated on the straight line basis based upon the life of that equipment and special equipment is determined in the same manner. All of the other plant of the company is currently depreciated at a 3 percent rate.

Q. Confining ourselves for the moment to transportation equipment which is shown on Page 3 of your Ex-

hibit 99, I refer you to Footnote 3 at the bottom of the page, which reads as follows:

"Amounts cleared from these accounts are not charged to depreciation account but to various operating expense and maintenance accounts, construction, etc., based on miles of use of automotive equipment and hours' use of special equipment."

[fol. 8303] It is apparent from that footnote that the company's operating expense accounts and construction accounts include the amounts required for the depreciation of this transportation equipment. Is that correct?

A. That is correct, yes, sir.

Q. In your pro forma statement which is Exhibit No. 104, you have included all of those operating expenses for the year ended June 30, 1941, have you not?

A. Yes, sir.

Q. So that you have already provided for the amortization of the transportation equipment through the medium of your expense accounts and your capital accounts, have you not?

A. Only partially. Some we related to Exhibit 98. Some portion of the amount of \$2,484.58 and \$198.96 appearing on Page 3 of Exhibit 99 was duplicated in the pro forma statement.

Q. Yes, I was coming to that.

A. Excuse me for anticipating you, Mr. Littman. It was evident that was what you were coming to.

Mr. Baldridge: To get me clear on that, I would like to ask is that the matter that was taken up by you with the representatives of the Commission in advance of the hearing?

The Witness: No, I would not say it was taken up by me with them, no.

Mr. Baldridge: Wasn't that communicated to the representatives of the Commission?

The Witness: No, I do not think so, not by me.

By Mr. Littman:

Q. Let me see if I understand your testimony. You provide in Exhibit 98 the amount of \$7,802.08 annually for the amortization of short-lived property, do you not?

A. That is correct.

Q. You state that you have made a duplication in so doing, isn't that right? A. That is correct, yes.

Q. Can you state how much of the \$7,802 is duplicated?

A. No, sir, I cannot. It would be something less than \$2,683.54 which is the aggregate of the two amounts I quoted from Page 3 under the column designated, "H" in Exhibit 99.

Q. Isn't your provision for amortization of passenger cars and trucks and trailers shown in Exhibit 98 duplicated entirely?

A. Not with respect to operating expenses, Mr. Littman, I do not think so; not with respect to the item of amortization as an operating expense.

Q. Certain parts of the cost of amortizing the short-lived property has been charged to this capital, has it not?

A. In the past, that is correct.

Q. And that capital is included in your original cost statement, isn't it?

[fol. 8305] A. Yes, it is included in the amount of original cost.

Q. And you are claiming a return on that amount of capital, are you not?

A. Yes, sir.

Q. And amortization of that?

A. Yes, sir.

Q. So when you say you have duplicated only \$2,000 out of \$7,802, you mean that that is all you can trace to the operating expense accounts?

A. No, what I am saying is that the amount of duplication cannot be any more than \$2,863.54 and that as it relates to operating expenses, it is something less than that amount, a rather small amount less, too.

Q. Then the difference between the \$2,000 of duplication, approximately, and the \$7,802 which you claim in Exhibit 98 is occasioned by reason of the higher rates of depreciation used by you over those used by the company?

A. That is correct.

Q. Now, Mr. Spitznagle—

A. (Interposing) Just a minute, I must explain my answer to that question a little further.

Q. Very well.

A. It is due to the fact that the rates may be somewhat higher and the fact that we are now making a provision for amortization of all of the cost that will be sufficient during the $24\frac{1}{2}$ years from June 30, 1941, rather than the cost of the equipment that the company presently has in its plant account at June 30, 1941.

Q. Isn't this one of the things that happens when you deviate from the accounting methods and policies followed by the company? Isn't this the inevitable result of tampering with the company's depreciation policies?

A. No, I do not think so, Mr. Littman.

Q. Well, it is what happened in this proceeding, isn't it?

A. Yes. It is entirely my responsibility. I neglected to apply as a reduction the amount of depreciation cleared through clearing accounts to operating expense accounts from the annual amortization of \$7,802.08.

Q. If the company's records show \$2,000 per annum for amortization of short-lived property against your \$7,000, do you think the company has overstated their property?

A. No, sir, I do not. This is a rate case and this was made up for the purpose of being used in a rate case so that we had to know how much amortization you would have to have presently and every year of the $24\frac{1}{2}$ year period in order to recover the total amount of the investment that was going to be made in property during that period. The company is not keeping its books strictly for rate case purposes.

Q. Well, if the company followed its own method, it [fol. S307] would also recover its investment, would it not?

A. It would recover it at a later period if it continued to make the provision year in and year out for $24\frac{1}{2}$ years and it will recover enough to take care of its property. Whether or not the recovery for the year ended June 30, 1941, would be sufficient to protect the company on the basis of determining what its rate should be based upon

that period is an entirely different factor and an entirely different approach to the problem.

Q. Apparently the company itself thinks that its own method is sufficient for the purposes of recovering its investment in short-lived property, doesn't it?

A. You will have to ask the company that, Mr. Littman. I presume they are because they have not changed it.

Q. Have you asked the company whether they are satisfied with their method?

A. No, I have not asked the company whether they are satisfied or not.

Q. You are not taking any responsibility for the philosophy back of this exhibit and whether Exhibit 98 reflects a proper method or not?

A. No, I have taken no responsibility although I have given you some philosophy in the last few minutes.

Q. But it is not the company's philosophy, is it?

A. The company subscribed to these statements so I [fol. 8308] presume they are satisfied with them.

Q. They are satisfied with the method that they have heretofore used?

A. I do not know about that, Mr. Littman. For this purpose, they subscribed to the presentation that we made and put confidence in me in the computation that was carried from Exhibit 98 to 104 and I let them down when I made a mistake here of roughly \$2,400.

Q. Exclusive of the amount that will be found in the capital accounts?

A. That \$2,400 would include any amounts that would be found in the capital accounts as well, Mr. Littman.

Q. But not for prior years, would it?

A. No, not for prior years, that is right.

Q. If the Commission were to take the company's own actual operating and maintenance expenses for the year ended December 31, 1941, as a guide for the future in testing the reasonableness of the rates of Michigan Gas, there would, by that process, be automatically included the company's own allowance for the amortization of short-lived property, isn't that correct?

A. In so far as the amount of short-lived property during the year 1941, yes, that is correct.

Q. Are you providing for amortization in Exhibit 98 of property that is not now owned by the company?

[fol. 8309] A. Yes, sir. I think the exhibit says that very distinctly, Mr. Littman.

Q. And that property, of course, is not purchased yet and is not used and useful in the rendition of service, is it?

A. It will have to be purchased and used in the continuation of the rendition of service.

Q. In the future?

A. In the future, yes, that is right.

Q. Would you think it proper to amortize cash in the bank, Mr. Spitznagle?

A. No, sir.

Q. You would not think of amortizing working capital, would you?

A. No, sir.

Q. You have not read Mr. Coffman's testimony on those subjects, have you?

A. I have a recollection I did.

Q. You do not agree with him in those regards, at least, do you?

A. I think you had better let Mr. Coffman speak for himself. I do not know what his philosophy is.

Q. Neither do we.

Mr. Spitznagle, will you please turn to Exhibit No. 99, entitled, "Michigan Gas Transmission Corporation—Statement of Income and Expense per Books for Years [fol. 8310] Ended December 31, 1936, to 1940, Inclusive; 12 Months ended June 30, 1941, and 6 Months Ended June 30, 1941, and December 31, 1940."

The company has followed a policy of overstating on its books the Federal income tax and excess profits taxes, has it not?

A. I could not designate it as an overstatement, Mr. Littman. They have stated on their books an amount payable or reserve for those taxes in excess of the amounts they paid, but there is a very good reason for doing that.

Q. Why? What is the reason?

A. Well, you will note that—

Q. (Interposing) By the way, before you proceed with your explanation, may I interrupt to point out that the excess accruals on account of Federal income and excess profits taxes are set forth in Footnote B, are they not?

A. Yes, sir.

Q. Now, will you proceed with your explanation?

A. You will note that the excess of accruals of Federal taxes over amounts paid are not material until the year 1940 which is shown in the footnote at the bottom of Column G.

Q. Will you read into the record the amounts of those excess accruals?

A. All of them?

Q. For the year 1940 and for the year 1941.
[fol. 8311] A. The 12 months ended 1941?

Q. Yes.

A. For the year 1940, Federal income taxes, meaning normal tax, was over-accrued \$16,184.67; Federal excess profits taxes were over-accrued \$135,595.15.

For the 12 months ended June 30, 1941, the respective taxes were over-accrued \$19,228.14 and \$123,495.62.

Q. Now, these over-accruals or excess accruals had the effect of understating the true net income to the same extent as the taxes were over-accrued. Is that right?

A. Yes, that is correct.

Q. In other words, the net income figures shown in Line 19 and Line 12 are understated in your Column G, 1940, and for the 12 months ended June 30, 1941, in Column H to the extent of the amounts shown in Footnote B. Is that right?

A. That is correct.

Q. While we are on the subject of Federal income taxes, you have recomputed Federal income taxes for purposes of your pro forma statement, have you not?

A. Yes, sir, that is correct.

Q. That is shown on Pages 4 and 5, I believe, of your Exhibit 104?

A. Yes, sir.

Q. Was this computation based upon the pro forma allowable utility income determined by Mr. Green?

[fol. 8312] A. No, sir, it is not, Mr. Littman.

Q. Well, is it determined upon the pro forma allowable utility income?

A. It is determined upon the allowable utility income as it is set forth on Page 1 of Exhibit 104, adjusted to conform to the requirements of the Bureau of Internal Revenue under the Income Tax Laws.

Q. Well, it is based primarily upon the—

A. (Interposing) The utility income allowable is adjusted for Federal income taxes deducted in arriving at the pro forma utility income. You have to have that in the bank as one element and then there are some other items which are more or less detailed in Item 11 on Page 4 and Page 5 of Exhibit 104.

Q. If the allowable utility income shown in the pro forma statement, Exhibit 104, is too high, the amount of tax shown would have to be reduced, accordingly, would it not?

A. I think that would be the result, Mr. Littman, yes.

Q. That would naturally follow?

A. That would follow, yes, sir.

Q. Now, for rate case purposes, it is necessary to first determine the allowable utility income before you can begin to compute the allowable Federal income tax and the Federal excess profits tax, isn't that correct?

A. Yes, sir.

[fol. 8313] Q. Now, that is almost axiomatic?

A. It is axiomatic.

Q. You never determine Federal income taxes first and then, on that basis, determine what your allowable net income is going to be, do you?

A. Well, we might make the determination on the basis of what we thought the allowable income should be, but you must determine the allowable income first.

Q. That is the proper way to do it, isn't it?

A. That is correct. It is the only way you can do it, in fact.

Q. Mr. Coffman has another way, that is why I wanted to get your understanding of it.

Mr. Spitznagle, I think we should now go to Exhibit No. 104 which is the pro forma statement. What do you mean by "pro forma statement"?

A. What I mean by it is a statement which will adjust actual book figures for all events that may have transpired during the period that is being reviewed in the pro forma statement which were not fully reflected in the actual statements of the company and for those events that may have occurred subsequent to the period for which the pro forma statement is prepared and will materially

affect the company's future income with respect to the actual period reported on. If I have not made myself entirely clear, I will be glad to try to do better.

[fol. 8314] Q. You make certain adjustments of the actual figures shown on the company's books for the purpose of making a forecast of things to come in the future, is not that right?

A. That is right, that is one of the elements, yes, that is correct, and to reflect change in philosophy over the philosophy expressed in the company's books as distinguished from that which is expressed in this statement.

Q. You are not intimating that accountants are, also, philosophers, are you?

A. I have seen quite a few of them who claimed to be.

Q. At any rate, one of the major purposes of a pro forma statement is to tie all of the figures together in one place and present a forecast of the future?

A. No, not necessarily a forecast of the future but to express what the future will hold with relation to the present. In other words, we are reporting here on the 12 months ended June 30, 1941. We attempted to show that if all conditions that we know about plus those that existed in the 12 months ended June 30, 1941, were to take effect in the next year, this would be the result and we, also, injected the change in philosophy on amortization of the investment over what was done by the company on its books.

Q. Do you consider this pro forma statement a reasonable forecast of expenses in operating income for the future?

[fol. 8315] A. I really have little knowledge, Mr. Littman, about what the future will produce in the way of revenue, expense and gross income and net income. There is a slight forecast in this statement in that we tried to apply the effect of completing construction work in progress, which would be completed subsequent to the date of June 30, 1941. To that extent there is forecast in this statement as to the future.

Q. Well, perhaps, I could state your philosophy better in this way: You used the latest available figures on the company's book available to you at the time you prepared

the pro forma statement, Exhibit 104, for purposes of testing the reasonableness of the rates?

A. That is correct.

Q. And you made certain adjustments of those figures because you knew there were going to be certain changes to come in this succeeding period?

A. Some had actually occurred which had not been fully reflected in the actual figures and some we knew were going to occur. In fact, arrangements had already been made for them to occur and we knew they would affect the operations of the company had they been in effect during the 12 months ended June 30, 1941.

Q. You made certain adjustments in the operating expenses, did you not?

A. Yes, sir.

[fol. 8316] Q. For instance, one of the things that you did was to make retroactive certain pay rises?

A. Wage adjustments that were made effective on July 1, the day after the period covered by this statement, that is correct.

Q. And you projected those pay rises back a full year, did you not?

A. That is correct, yes.

Q. We will take these matters up in detail later, but I wanted to touch upon them briefly at this time.

You, also, took into effect certain purported reductions in rates that became effective from time to time through the 12 months ended June 30, 1941, and projected those back for the entire 12 months, did you not?

A. That is correct and some rates that were filed with the Federal Power Commission that had not yet been approved by them that would, again, affect that same period.

Q. Now, will you point out in this statement where you have given any effect to future changes in revenue?

A. We have not, only to the extent of Item 6 on this statement captioned, "Estimated Reduction in Utility Income Before Depreciation and Federal Income Taxes Resulting from Completion of Construction in Progress at June 30, 1941", which is an exhibit, the number of which I do not know, in this proceeding. Only to that extent, Mr. Littman.

[fol. 8317] Q. Well, you make a slight adjustment, do you not?

A. That is a slight figure by the way of net revenue less expenses.

Q. Well, you also made an adjustment shown in Item 4 of Page 1 of Exhibit 104 for an increase in rates to Kentucky Natural Gas Corporation in the amount of \$3,333.

A. That is correct. That is a contractual arrangement and we knew definitely that that was going to occur, so we put it in.

Q. Well, you made no forecast of revenues in the future, did you not?

A. No, sir.

Q. Well, what is pro forma about these revenues that are shown in Exhibit 104 other than the two small items that you mention?

A. There is nothing pro forma about them, Mr. Littman. There was no intention to pro forma them in the respect that you are now asking me.

Q. Well, you pro forma-ed, so to speak, the operating expenses, did you not?

A. Those changes that were apparent and we knew definitely about, yes. We did not pro forma the operating expenses for the indicated rise in cost of operation due to changing labor rates and changing cost of materials and supplies and what not. We did not pro forma those expenses.

[fol. 8318] Q. Now, that would not amount to much, would it?

A. I do not know, Mr. Littman. I do not know, it is a very difficult thing to determine.

Q. Well, you pro forma-ed, so to speak, the operating expenses and reflected the rise in wages, did you not?

A. To the extent that it was actually known that it had occurred.

Q. You, also, made a pro forma statement for purposes of depreciation, did you not, and amortization?

A. We reflected in the statement the changed philosophy that has been prosecuted in the Michigan Consolidated Gas case right straight on through.

Q. Well, you pro forma-ed, so to speak, the bad news, but you did not pro forma the good news.

A. That was not our purpose, Mr. Littman, to pro forma the bad news and not pro forma the good news. We thought we would put in the facts that were apparent that we knew about.

Q. Did you not know that M.c.f. sales and M.c.f. transported was going to increase in the next year?

A. I had every reason to believe that it would, yes, Mr. Littman.

Q. But you did not reflect anything for that, did you?

A. No, because it is very difficult to determine and, by the same token, I knew that expenses were going to increase by virtue of increased cost of wages, I mean generally, increased cost of materials and supplies and we [fol. 8319] did not pro forma those either which we would have to do. If we were going to pick up the trend in revenue, we would have to pick up the trend in all types of expenses and to make such a computation and defend it is a very difficult thing to do.

Q. Let's look at the gas operating revenues shown in the income and expense statement, Exhibit No. 99. Now, there has been a steady rise in those gas operating revenues from the beginning of the company to June 30, 1941, as shown in Line 4 of Page 1 of this exhibit. Is not that correct?

A. Yes, sir, that is true.

Q. And you fully expect the trend to be in the same direction, do you not?

A. Well, due to the nature of this particular company's business, it is very difficult to relate the trend to the operating revenues. For the 12 months ended December 31, 1941, the operating revenues are \$5,527,794.76, whereas in the company's budget for 1941 they are greatly reduced for the reason that the company is changing its method of reporting revenues.

In other words, the company sells gas as such to some people and they transport gas for a service charge. If you change the ratios of those two classes of service you naturally change the resulting operating revenue.

Q. Well, the operating expenses go down, too, when they [fol. 8320] cease buying gas for resale. Then they transport it?

A. Yes, that is true.

Q. Let's not talk about revenues in view of that, let's talk about net utility income shown on Line 12.

A. That would be better.

Q. That shows a steady upward trend from the beginning of the operations of the company in 1936 through to June 30, 1941?

A. That is correct.

Q. Now, in your opinion, should not a pro forma statement give effect to the increased sales and volumes of gas transported in order to fully reflect changed conditions?

A. If the facts can be reasonably determined, both with relation to the income statement as well as to the additional capital that will have to be invested in connection with the maintenance of the present income as well as the future income, yes, I would say so.

Q. Well, we can now look in the budget for that, can we not?

A. Well, you have another 6-months' period. You can look at the results for that 6-months' period and see what the change is, Mr. Littman, yes.

Q. And the results of the last 6-months' period of 1941 are shown in the company's financial statement for 1941, which is now identified as Exhibit No. 163?

[fol. 8321] A. At least they can be adduced from that exhibit, yes, Mr. Littman.

Q. What was the total amount of gas in M.c.f. transported and sold by Michigan Gas during the year ended June 30, 1941? I believe you will find that in Line 25 of Column "H" of Exhibit 103.

A. I do not seem to have a copy of Exhibit 103. 38,555,662 M.c.f.

Q. What is the volume of gas in M.c.f. transported and sold per your pro forma statement? I take it it is the same amount?

A. It is not quite the same amount, because we did give consideration to taking in any income that would result from completing construction work in progress which involved, of course, the sale of some additional M.c.f. How many M.c.f.'s there are, I could not tell you.

Q. That did not amount to much, did it?

A. Not a great deal, no.

Q. In other words, there is nothing particularly pro forma about the number of M.c.f.'s transported and sold in your pro forma statement? A. That is true, yes, sir.

Q. What was the actual amount of gas in M.c.f.'s transported and sold in the year ended December 31, 1941?

I believe you will find that figure on Page 4-B of Exhibit [fol. 8322] No. 163.

A. Yes, I have that, but these figures are confusing to me because of the delivery feature and the sale feature. I take it that the comparable figure to the one I previously quoted for the 12 months ended June 30, 1941, is 41,304,280 M.c.f.

Q. Will you please deduct the gas used by the company in the amount of 423,552 M.c.f.? A. Yes.

Q. When that is done, I believe you will have the comparable figure. A. 40,880,728 M.c.f.

Q. Now, there was an increase of 2,325,066 M.c.f. sold and transported for the year ended December 31, 1941, over the volume transported and sold for the period used in your pro forma statement, to wit, the 12 months ended June 30, 1941, is that correct?

A. That is the approximate figure, Mr. Littman.

Q. Now, Michigan Gas Transmission Corporation has made its own forecast of the quantity of gas which it expects to sell and transport for the year 1942, isn't that correct? A. That is true, yes, sir.

Q. Will you give us that figure?

Mr. Baldridge: May I interject there. In what form was that forecast made, Mr. Spitznagle?

[fol. 8323] The Witness: What do you mean by "form"?

Mr. Baldridge: Well, in what document is it contained?

The Witness: It is contained in the company's designated operating budget for the year 1942.

Mr. Baldridge: Will you read the date on the outside of that, please?

The Witness: I find the date on the fly sheet indicating that it was prepared December 5, 1941. Is that what you want? It is signed as of that date.

Mr. Baldridge: December 5, 1941, yes.

The Witness: Yes.

By Mr. Littman:

Q. Who signed it?

A. Mr. L. J. Mueller, Assistant Treasurer of the Company.

Q. Assistant Treasurer—

A. (Interposing) Of Michigan Gas Transmission Corporation.

[fol. 8326]

FRED A. SPITZNAGLE a witness, having been previously duly sworn, resumed the stand and testified further as follows:

Cross-Examination (Resumed)

By Mr. Littman:

Q. Mr. Spitznagle, yesterday I requested you to make a check of a number of figures, as the transcript of yesterday will more clearly show. Have you checked the accuracy of our calculations and the figures which I submitted to you to be checked? A. Yes, sir.

Q. And what did you find?

A. I found that the figures as you quoted them were correct. I also found that in connection with expenditures of the character detailed in Exhibit 93 which have been charged by Michigan Gas Transmission Corporation, that they have been charged on its books to sales promotion expense.

Q. You are now referring to the charges appearing in Exhibit 93 which are there characterized as "Contributions Made to Customers for Business Development for the Years 1936, 1937 and five Months Ending May 31, 1938"?

[fol. 8327] A. That is correct, yes, sir.

Q. I believe I also read some figures to you which we believed to be the amounts charged by Michigan Gas Transmission Corporation to sales promotion expense for the balance of the year 1938, for 1939, 1940 and 1941.

A. That is correct.

Q. Did you check the correctness of those figures?

A. Those are included in the figures that I just previously testified to, yes, sir.

Q. Mr. Spitznagle, I also asked you to ascertain for me the manner of payment of the Federal income taxes by the company. A. Yes, sir.

Q. What are the facts?

A. It has been the policy of the company to pay its Federal income taxes quarterly.

Q. What has been the policy of the company with respect to the payment of its Indiana taxes?

A. Those taxes are payable by the company on the first Monday in May and November following the year for which the accrual for those taxes is made, so that the 1941 accrual of taxes for Indiana property taxes will be payable the first Monday of May and November of 1942.

Q. That brings us down to date with respect to the checking of figures and your further responses to checking the [fol. 8328] information? A: Yes, sir, I think it does.

Q. At the close of yesterday's session, we were discussing Michigan Gas' forecast of the quantity of gas to be sold and transported for the year ended December 31, 1942. I believe you were about to refer to the forecast with respect to those sales and that transportation as contained in the 1942 operating budget of Michigan Gas Transmission Corporation. Do you have the figure before you?

A. Yes, sir. I would like to point out before I give you the figure that the company considers it a forecast, the document that you refer to as a budget. It is not a budget in the sense that it has been approved by the officers and Directors of the Michigan Gas Transmission Corporation.

Further, of course, the budget was prepared, the forecast was prepared, prior to the advent of the present struggle that we are now engaged in.

Q. Well, just a minute, Mr. Spitznagle. By the statement you just made, are you referring to the entire budget or to the forecast of sales and a forecast of the volume of M.c.f.'s to be sold and transported during the year 1942?

A. I am referring, more or less, to the entire budget with the possible exception of the capital expenditures set out in the budget, Mr. Littman.

Q. Who prepared this budget?

[fol. 8329] A. It is prepared by the officers of Michigan Gas Transmission Corporation, primarily Mr. Mueller, the Assistant Treasurer of the company.

Q. Well, if the officers of the Michigan Gas Transmission Corporation prepared it, why, they approved it, did they not?

A. Well, they think that it is as good as they could do at that time in forecasting the 1942 operations of the company. I am sure they feel that.

Q. You understand that it represents—

A. (Interposing) But it does not represent a budget in the sense that such budgets are prepared for formal approval by Directors and officers of the company. That was the only point that I wished to make.

Mr. Baldridge: May I interject a question, Mr. Littman?

Mr. Littman: Do you mind waiting just a minute, Mr. Baldridge? I want to clear up the point on this budget.

By Mr. Littman:

Q. You have stated that this budget has not been approved by the Board of Directors of Michigan Gas Transmission Corporation. Is it not a fact that none of the previous budgets have been submitted to the Board of Directors of Michigan Gas?

A. That is true, they have not followed that practice with respect to the annual forecast in the past periods, that [fol. 8330] is correct.

Q. This 1942 budget has been prepared and submitted to the officers of the company just as it always has been done in the past, is that not correct?

A. That is correct, yes.

Q. In other words, this 1942 budget is not any less formal or less complete than any of the other budgets?

A. That is correct, yes, sir.

The amount responsive to your original question is \$7,014,779 M.c.f.

Mr. Littman: Mr. Baldridge, you said you wanted to clear up something.

Mr. Baldridge: You spoke of the officers preparing this budget. You did not mean to include the Directors in that, did you?

The Witness: Mr. Baldridge, I do not know really to what extent all of the officers have perused or examined the budget in any way, shape or form.

Mr. Baldridge: You have no information which would lead us to believe that Mr. Beckjord had any part in the preparation of the so-called budget?

The Witness: No, I have no such information, that is right.

Mr. Baldridge: Just to clear the record further, Mr. Beckjord was President of Michigan Gas Transmission Corporation up until February of this year, was he not?

[fol. 8331] The Witness: I do not know the exact date, but I know it was some date in February, yes, sir.

Mr. Baldridge: And at the present time Mr. Crevelling is President of Michigan Gas Transmission Corporation?

The Witness: That is my understanding.

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[fol. 8332] By Mr. Littman:

Q. What did you say with respect to Mr. Beckjord's known participation in the 1942 budget preparation?

A. I will have to have the question read back to me that Mr. Baldridge asked me. I do not recollect just right off, Mr. Littman. I have no knowledge whatsoever as to Mr. Beckjord's participation in this budget and I tried to convey that impression by my answer to Mr. Baldridge.

Q. Well, I thought the inference was being made that Mr. Beckjord did not participate in the preparation of this budget.

A. I do not know, Mr. Littman.

Q. You do not know whether he has or has not participated in the preparation of previous budgets, either, do you? A. Not specifically, no, I do not.

Mr. Baldridge: May I ask for a definition of the term there? When you refer to the budget, generally, I would like to point out the distinction between "budget" as it is ordinarily used and this so-called "operating budget" which is nothing more or less than a forecast.

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[fol. 8333] By Mr. Littman:

Q. Mr. Spitznagle, I hand you Exhibit No. 165 for [fol. 8334] identification and ask you whether this is the

document to which you have referred throughout your testimony as the operating budget of Michigan Gas Transmission Corporation for the year 1942? A. Yes, sir, it is.

Q. And it contains the forecasts to which we have been referring? A. Yes, it does.

[fol. 8335] Q. Mr. Spitznagle, who signed the original budget of 1942, a copy of which has been marked for identification as Exhibit No. 165?

A. The signature appearing on the copy that I have is L. J. Mueller, Assistant Treasurer, Michigan Gas Transmission Corporation.

[fol. 8337] Q. Now, you stated a few moments ago that the 1942 budget reflects a forecast of a total of 47,014,779 M. c. f.'s expected to be sold and delivered during the year 1942.

A. That is correct, yes, sir.

Q. Now, that represents an increase of 6,134,051 M. c. f. over the volume transported and sold during the full year 1941, does it not?

A. That figure is approximately correct.

Q. Now, do you know how that figure was arrived at by the officers of Michigan Gas Transmission Corporation who prepared this budget?

A. No, sir, I am not sufficiently familiar to give you the detail of the increase.

[fol. 8338] Q. Are you sufficiently familiar with Panhandle Eastern's Exhibit No. 40 which was submitted by Mr. Morton to state whether or not this forecast of gas sold and delivered closely approximates Mr. Morton's forecast of gas to be delivered east of Dana, Indiana, during the year 1942, by Panhandle Eastern Pipe Line Company?

Mr. Baldridge: Don't you want to change that question a little bit?

Mr. Littman: I am satisfied with it.

Mr. Baldridge. I will point out why it might not be entirely satisfactory. The gas delivered at Dana is not all delivered to Michigan Gas Transmission Corporation, as you may know. There is a delivery at Dana to somebody

else. Do you want to limit that delivery to Michigan Gas Transmission Corporation?

Mr. Littman: I shall clear that up.

By Mr. Littman:

Q. Are you familiar with Mr. Morton's estimate?

A. Mr. Littman, I have no familiarity with any of Panhandle's exhibits, including Mr. Morton's.

Q. In view of Mr. Baldridge's statement, I would like to point out that Mr. Morton's Exhibit No. 40 shows his estimated deliveries by Panhandle Eastern Pipe Line Company at Dana, Indiana, and into the lines of Michigan Gas Transmission Corporation for the year 1942 to be 50,711,870 M. c. f.'s.

[fol. 8339] Mr. Littman: I presume, Mr. Baldridge, that the difference between the 50 million figure and the 47 million figure contained in the budget would represent line loss, company use, and so forth?

Mr. Baldridge: I do not know whether it includes only that or something else, Mr. Littman. I just do not know.

By Mr. Littman:

Q. At any rate, Mr. Spitznagle, you are not familiar with Mr. Morton's estimate?

A. No, I am not, Mr. Littman.

Q. Will you please refer to your pro forma statement, Exhibit No. 104. I call your attention to Item 4 entitled, "Income from Rate Change—Kentucky Natural Gas Corporation", \$3,333. Is my understanding correct that this amount has been added to the revenues of Michigan Gas Transmission Corporation for pro forma purposes?

A. Yes, sir.

Q. To reflect a rate increase?

A. It is to reflect a change in the rate under the contract that occurred on September 1, 1941, or in the period ended June 30, 1941.

[fol. 8340] By Mr. Littman:

Q. What does it represent?

A. Are you asking me or Mr. Baldridge?

Q. I am asking you, Mr. Spitznagle.

A. The contract provides for an automatic change in the rate occurring on September 1, 1941. It is a fixed basis rate. In other words, it is \$12,000 per annum starting September 1, 1941, whereas up to that time, it was \$8,667. I do not have too much familiarity with the contract itself, Mr. Littman.

Q. Well, it is your testimony, is it not, as it appears on this pro forma statement, Exhibit No. 104, that the rate change to which you have referred would result in an overall increase in revenues derived from Kentucky Natural Gas Corporation for the full year of \$3,333?

A. That is correct, yes.

Q. What you have done is to take the increase effective September 1, 1941, and project it back to June 30, 1940, have you not? A. That is correct.

Q. If the Commission were to use the revenues of Michigan Gas Transmission Corporation for the full year 1941, the figure of \$3,333 would necessarily change, would it not?

A. That is correct.

Q. Is it also a fact that if the Commission were to use [fol. 8341] the revenues and expenses for the full year 1941, the Items 1, 2, 3 and 5 shown on Page 1 of Exhibit 104 would also change, would they not?

A. That is true, yes, sir.

Q. For the purpose of the record, Item 1 is "Depreciation per Books Adjusted"; Item 2, "Federal Income and Excess Profits Tax per Books Adjusted"; Item 3, "Reclassification of Donations per Books Adjusted to Deduct from Gross Income"; and Item 5 is "Increase During 12 Months Ended June 30, 1941, in Cost of Line Pack in Mains Not Capitalized." Is that correct?

A. That correctly describes the items you just referred to, yes, sir.

Q. Will you please refer to Item 6 on Page 1 of Exhibit 104, the pro forma statement, which item is called "Estimated Reduction in Utility Income Before Depreciation and Federal Income Taxes Resulting from Completion of Construction in Progress at June 30, 1941, on Exhibit 95". This item would also change, would it not, if the figures for the full year 1941 were used?

A. Yes, sir, that is true.

Q. As a matter of fact, the item would be practically eliminated, would it not?

A. Not entirely but a good portion of it would be already reflected in the last six months of 1941's operations.

[fol. 8342] Q. Isn't that because all but \$30,000 of the construction that was in progress at June 30, 1941, was completed at December 31, 1941?

A. I think the amount of \$30,000 is approximately the correct figure, yes, sir.

Q. That is my recollection of Mr. Young's testimony.

Looking at Item No. 7, "Amortization of Present Rate Case Expense," you have used the estimated figure for purposes of the pro forma statement which estimate was submitted by Mr. Young in Exhibit No. 96?

A. Yes, sir.

Q. What you have done for purposes of the pro forma statement is to amortize the estimated figure over a five-year period?

A. That is correct, yes, sir.

Q. Mr. Spitznagle, without referring to the amount which represents an allocated portion of the estimate contained in Exhibit No. 96 which has been stricken from evidence, I would like to ask you whether or not, in your opinion, you fully expect the estimate to change when the actual figures are in?

A. Yes, I do, Mr. Littman.

Q. It goes without saying, does it not, that the actual figures paid will be a much better guide for us than any estimates thereof?

A. I think that is generally true, yes, sir.

[fol. 8343] Q. Mr. Spitznagle, in your opinion, should rate case expense be included in a calculation which is made purely for the purpose of determining the reasonableness of existing rates?

A. It has been so included in rate cases that I know about before State Commissions. I am not very familiar with the practice of the Federal Power Commission toward that item. However, Mr. Green will support the philosophy of including it in this pro forma statement.

Q. You are not expressing any opinion on that subject?

A. That is correct.

Let us examine Item 9 on Page 1 of your pro forma statement, Exhibit No. 104, entitled, "Provisions for Wage In-

creases Made Not Reflected in Period Ended June 30, 1941."

Now, the amount shown for this item of \$22,099 represents what?

A. It represents the amount necessary to reflect the existing payroll of the company on July 1, 1941, for a full year ended June 30, 1941, in the operating expenses of the company.

Q. When were these wage increases effective?

A. The largest one was effective, as I recall, on July 1, 1941. I believe there were a few small ones made during the year ended June 30, 1941, as well.

[fol. 8344] Q. Now, the figures in the operating budget for the year 1942 which has been identified as Exhibit 165 reflect these provisions for wage increases, do they not?

A. Yes, sir, they do.

Q. Do you know whether they reflect any further increases for wages?

A. I do not think they do. In fact, I know the operating budget does not include the addition of some 18 watchmen at a cost of about \$21,000 a year because the budget was made before the declaration of war and did not contemplate putting on watchmen, of course, in 1942.

Q. In other words, the budget reflects the forecast as of December 5, 1941, which was two days before Pearl Harbor?

A. That is correct, yes, sir.

Q. If the expenses for the full year 1941 were used for purposes of testing the reasonableness of the rate and those figures are now in the record in the financial statement which has been identified as Exhibit 163, there would be reflected the actual wage increases in effect throughout the entire year 1941, isn't that correct?

A. No, I do not think that is true, Mr. Littman. A wage increase made on July 1, 1941, would not be fully reflected in the year 1941 because you would only have a six-months' period during which the wage increase was paid.

Q. But you would have all wages actually paid during [fol. 8345] the year 1941?

A. All the wages actually paid, that is true.

Q. Including the wage increases actually paid?

A. Correct, yes sir.

Q. And, of course, your Item 9 would be reduced accordingly, would it not?

A. That is true.

Q. Let us now take up Item 10 on Page 1 of Exhibit 104 which item is called, "Reduction in Income Resulting from Changes in Contracts for Sale and Purchase of Gas" in the amount of \$93,539.

There were certain rate reductions that became effective from time to time during the 12 months ended June 30, 1941, which is the period used by you for purposes of your pro forma statement, isn't that correct?

A. That is correct and, in addition, there were some contemplated and filed with the Federal Power Commission which have not been acted upon, as well.

Q. What did you do to arrive at this figure of \$93,539 to reflect the reduction in income—first, you did not use the actual income for the 12 months ended June 30, 1941, did you, with respect to these rate reductions—that is to say, you projected them back, didn't you?

A. Yes, the actual income was used in determining the amount that is expressed in this statement. I am not sufficiently familiar with the detail of the computation to fully explain it to you. Mr. Young is and I believe will be very glad to do it for you.

Q. You understand, generally, what was done, don't you?

A. Yes, very generally.

Q. You testified on this subject at Pages 1968 to 1970 of the transcript, did you not?

A. Yes, sir.

Q. And there you show the effective date of the rate reduction applicable to each of the various companies?

A. That is correct, yes, sir.

Q. Where, for example, in the case of Indiana Gas Distribution Corporation a rate reduction became effective June 1, 1941, as shown on Page 1969 of the transcript, you made an estimate of the reduction that would ensue had that reduction been made effective July 1, 1940; did you not?

A. That is correct.

Q. And you did that in each instance?

A. Yes, sir.

[fol. 8347] Q. Is there any confusion on this subject resulting from your direct testimony?

A. None that I know of, Mr. Littman.

Q. What is your understanding with respect to industrial sales by Indiana Gas Distribution Corporation?

A. Well, honestly, Mr. Littman, I am not sufficiently familiar with the types of rates that are in effect to give you very much intelligent information on the subject. I can check a computation, but to create that same computation I would have a lot of difficulty.

[fol. 8348] Q. I see. Well, who made the computation in the first place?

A. The computation was made by the staff of Michigan Gas Transmission Corporation.

Q. That is a computation of the \$93,539 shown in Item 10 of Exhibit 104?

A. That is correct, yes, sir. I might add that the Commission was given the work sheets for that computation and their staff have indicated to me that it is a rather complicated affair and I just cannot relate it to you.

Q. Well, we did not intend to go into the intricacies of this \$93,539, but so far as you know, this \$93,539 represents all of the reductions that would have resulted, had these rate reductions been effective throughout the entire 12-months' period ended June 30, 1941?

A. That is correct.

Q. And do you know of others?

A. I wish to add this, that the \$93,000 figure is an income figure rather than operating revenue figure. In other words, it is net of expenses. It is operating revenue less expenses.

Q. To what expenses do you refer?

A. To the cost of purchasing gas to the extent that that is involved in the change in revenue and other types of expense.

[fol. 8349] Q. Now, if the actual revenue figures for the full year 1941 were used, there would be fewer adjustments required. Isn't that right?

A. That is correct.

Q. And that is because many of these rate reductions were effective prior to January 1, 1941?

A. That is correct.

Q. And, of course, the \$93,539 figure would be reduced?

A. That is correct, yes, sir.

Q. Now, the operating budget for the year 1942 which has been identified as Exhibit 165 reflects all of these rate reductions, does it not?

A. That is my understanding, Mr. Littman, but I am not positive about it.

Q. You would not have to make any adjustments for that factor at all if you used the 1942 revenues, would you?

A. That is my understanding, Mr. Littman. I am not right sure about it, though.

Q. Now, with respect to Item 11 entitled "Federal Income Tax on Pro Forma Income" in the amount of \$181,492, what rates did you use in arriving at that amount?

A. The rates under the 1940 Act as amended by the 1941 Act.

Q. Well, are those the tax rates currently in effect?

A. Yes, sir, they are the rates in effect today.

[fol. 8350] Q. In other words, you applied today's rates to the last six months from the year 1940, at which time they were not effective, did you not?

A. Yes, that is correct.

Q. That is, to which period they were not effective?

A. Plus the adjustments that have been made in the pro forma statement, that is correct.

Q. Now, of course, if you were to use the 1941 figures for the full year 1941, you would have a full annual period that would require no adjustment except for an adjustment in net income. Do you follow me?

A. Not quite.

Q. Well, let me put it this way: You did not use for purposes of your pro forma statement the taxes actually paid during the 12 months ended June 30, 1941, did you?

A. No, sir.

Q. You had to make an adjustment there for the last six months of 1940, did you not?

A. That is correct, for the Act that was in effect at the time we prepared the pro forma.

Q. Now, with respect to the balance of the items on this pro forma statement, Exhibit No. 104, I take it that those

were developed by Mr. Green, were they not, except for Item 12 which we have heretofore discussed?

A. Yes, sir, that is true. Of course, I made some of [fol. 8351] the computations and converted the philosophy represented by the conclusion of those items into the dollar amounts there shown.

Q. Who is taking responsibility for Item 13 which has to do with the amortization of long-term investment and the cost of developing business?

A. Mr. Green has taken the responsibility for that act.

Mr. Littman: We have no further cross-examination of this witness.

I would like, at this time, to offer in evidence Exhibits Nos. 163 and 164.

(Exhibits Nos. 163 and 164 Were Received in Evidence.)

[fol. 8352] Q. Mr. Spitznagle, will you first refer to your Exhibit No. 91?

A. I have it, yes, sir.

Q. Now, in making your examination of the accounts of Michigan Gas Transmission Corporation, you found that that company had been organized in November of 1935, did you not, and that Indiana Gas Transmission Corporation had been organized back in 1931?

A. I think that is substantially correct, yes, sir.

Q. And that they have been consolidated as of March 1, 1936?

A. That is correct, yes, sir.

Q. Now, you also found the books of account of Indiana Gas Transmission in the Detroit office?

A. Yes, sir.

Q. Indiana Gas Transmission Corporation began the sale of gas in 1931, did it not?

[fol. 8353] Q. I am handing you, Mr. Spitznagle, what I understand to be a copy of an exhibit filed with the Securities and Exchange Commission in recent hearings there in

which, among other things, there was involved the matter of the sale of Michigan Gas Transportation Corporation and I would like to ask that during the noon intermission you check that and see if those figures are correctly copied. I think that you can check everything except the last line, [fol. 8354] which is probably not in those records.

A. Yes, sir.

Trial Examiner: This tabulation will be marked for identification as Exhibit 166:

(Exhibit No. 166 Was Marked For Identification.)

Q. Also, I would like to have you set down on this sheet the amount received for those sales.

[fol. 8355] Mr. Baldridge: I think if you ask us to do some work on this thing, I think we at least ought to know whether it has any bearing on our case or not. It does not seem to me that it does.

Mr. Chamberlain: If you would like to know, Mr. Baldridge, it will have this effect: It will show why Indiana Gas Transmission was not selling any gas. You introduced an exhibit which shows it fairly well, but that will confirm it.

Mr. Baldridge: What has that to do with the Michigan Gas Transmission Corporation case, Mr. Chamberlain, that is what I want to know. Aren't you really talking now about the Panhandle Eastern Pipe Line case?

Mr. Chamberlain: I am discussing exhibits already filed by Michigan Gas Transmission Corporation and introduced by you, as I understand it.

[fol. 8356] Mr. Littman: Weren't these sales made over the lines presently owned by Michigan Gas Transmission Corporation?

Mr. Chamberlain: They were made by the Michigan Gas Transmission Corporation because it is a consolidated and merged company.

[fol. 8357] Mr. Littman: I so understood.

Mr. Chamberlain: These were made by Michigan Gas Transmission Corporation under the name of Indiana Gas Transmission Corporation. This is a consolidation and merger. It is one company which has been operating since 1931 in the same way that Panhandle Eastern has been operating.

Now, if counsel wants a statement of what the purpose of this is, on Exhibit 101, he has introduced evidence here which shows that Indiana Gas Transmission Corporation, after five years of serving gas, had six customers. It shows the price that it was charging for gas, which was a prohibitive price, was purely and intentionally charged to defeat the sales of gas at that time.

Mr. Chamberlain: That is right, it shows right here and this completes the story throughout the years. It also shows from this exhibit that when the price of gas was reduced, sales increased very nicely. It shows fine salesmanship after 1936 but it will give this Commission a very potent reason why there is no going value with respect to attaching business.

Trial Examiner: I take it, Mr. Chamberlain, that that last part of your statement indicates the fundamental reason for this inquiry, that is, the cost of business development?

Mr. Chamberlain: That is right.

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[fol. 8361] Q. Now, I want to call your attention to Exhibits 101 and 103. Are the two not companion exhibits?

A. If you mean does Exhibit 101 show the M.e.f. related to dollar amounts of the various companies described and detailed in Exhibit No. 102, yes.

[fol. 8362] Q. Now, I observe that you have listed the customers and sales of Indiana Gas Transmission Corporation on Exhibit 101 for the first two months of 1936. Is that correct?

A. That is correct, yes, sir, for the purpose of supplying information for the full year 1936.

Q. Yes, and that shows a total of seven customers, does it not?

A. Yes, sir.

Q. Now, included in that is the Ohio Fuel Gas with some \$209,000 of payment for the two months, is there not?

A. That is correct, yes, sir.

Q. Please refer to Exhibit 103 and state whether that indicates that purchases were kept up in any substantial amount after 1936 by Ohio Fuel Gas Company?

A. Your question is not entirely clear to me. I think you mean did the Ohio Fuel Gas Company continue to buy gas in the same volume?

Q. In any substantial quantity after 1936.

A. Exhibit 103 shows that Ohio Fuel Gas Company purchased in 1937, 13,185 M.c.f. and, in 1936, 2,767,835 M.c.f. from the two companies denoted in the statement under the column headed "1936".

Q. There were no large sales to Ohio Fuel Gas Company after 1936, were there?

[fol. 8363] A. That is correct.

Q. Now, did you notice the change in that account when you prepared the exhibit, in the way it dropped off?

A. Yes, I perhaps observed it.

Q. Did you make any inquiry as to what period in 1936 that gas was taken?

A. No, sir, I did not, except as is shown on here for the two months and ten months period described under the column "1936".

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[fol. 8366] ROBERT S. DREW; a witness, having been previously duly sworn, resumed the stand, was examined and testified as follows:

Cross-Examination (Resumed).

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[fol. 8367] By Mr. Littman:

Q. Mr. Drew, you are Vice President of Continental Illinois National Bank & Trust Company of Chicago?

A. Yes, sir.

Q. You are in charge of the Investment Trust Department of that institution?

A. Well, I refer to it as the Investment Trust Division. It is the Investment Department of the Trust Division. That is what you mean; I think

Q. As I understand your testimony, Mr. Drew, you were requested by Mr. Daniel C. Green to give an opinion as to the question, "What rate of return should a company like the Michigan Gas Transmission Corporation earn on its invested capital or fair value in order to be able to finance by public offering of securities?" Is that correct?

A. Yes, sir.

Q. What conclusion did you reach in answering that question?

A. I believe I stated in my direct testimony that in my opinion the rate of return which a company like the Michigan Gas Transmission Corporation should earn on its invested capital or fair value, in order to be able to finance itself at this time by public offering of securities, is at least eight and one-half percent.

Q. In other words, the eight and one-half percent rate [fol. 8368] of return which you have just given applies to to either invested capital or fair value?

A. Well, in my thinking with respect to the words "fair value" I relate that term directly to the market value of the company's securities, which is the primary thing that I was testifying on in this case.

Q. Well, do you understand that invested capital and fair value are equal to each other?

A. Not necessarily; but I should say that there is likely to be a pretty close relationship between the market value of the securities of the corporation and what may be regarded as its fair value.

Q. I take it from your answer that it would not make any difference in your estimate of rate of return whether invested capital or fair value were used as the rate base?

A. My opinion is not worth anything on that point. I am talking about market value of securities.

Q. Well, the thing I am trying to ascertain, Mr. Drew, is to what this eight and one-half percent should be applied. In other words, to what is it referable?

A. For the purpose for which I use that expression here, it relates to the market value of securities of the corporation.

Q. And not to anything else?

[fol. 8369] A. Well, I think it would have some relationship to other figures and factors, but my use of it relates to the market value of the securities.

Q. Suppose the market value of the securities were less than the book value of the securities. You would still say that the eight and one-half percent rate should be applied to the market value of the securities?

A. Well, I would not say applied to the market value; I would say that, repeating my direct testimony, in order to finance itself publicly at this time, a company like Michigan Gas Transmission Corporation would have to have net earnings of about eight and a half percent, at least eight and a half percent on the market value of those securities.

Q. Well, at the time you made this study, Michigan Gas Transmission Corporation's securities were not bought and sold on the market, were they?

A. I believe not.

Q. So you did not have at that time any estimate of the market value of those securities, did you?

A. There were no market quotations for their securities, so far as I know.

Trial Examiner: I believe your testimony was given in this case previously on November 18, Mr. Drew, and I do not recall whether you stated when your study was made. Can you give the dates when your study was actually made?

The Witness: My working papers here, one set shows [fol. 8370] the date of October 25, 1941, and this work sheet is dated November 14, 1941.

By Mr. Littman:

Q. Didn't you, in reality, make your study as of November 12, 1941?

A. We used market prices as of November 12, 1941.

Q. Now, none of the securities of Michigan Gas Transmission Corporation are bought and sold on the market today, are they?

A. Not so far as I know, sir.

Q. Have you ever heard of a rate base for rate making purposes that was determined by the market value of securities of a public utility?

A. I do not recall having heard of any such case, but I am not in a position to know very many rate cases. I do not follow them, as a practice.

Q. Well then, it is your testimony that your eight and one-half percent is applicable and referable to market value of securities? A. Yes, sir.

Q. And there is no market value of the securities of the utility in question as of the date you made your study, or as of today?

A. There are no market quotations for the securities of the corporation so far as I know, but I should say that [fol. 8371] those securities could have a market value.

Q. You have not ascertained what that market value is, have you? A. No, I have not.

Q. Well, can this eight and a half percent return, which you have estimated, be properly applied to any other kind of a rate base besides the market value of the securities?

A. I have no opinion to offer on that, Mr. Littman.

Q. You understand, Mr. Drew, it is very important for the Commission to know, because, obviously, if the eight and one-half percent is applied to one rate base, it may produce a different amount of dollars of return than if applied to another rate base. You understand that, do you not? A. Yes.

Q. And you cannot help us out on that score?

A. I do not believe I am qualified to answer that question.

Q. Would your eight and one-half percent rate of return be properly applicable to an original cost rate base or don't you know that either?

A. I do not think I am qualified to answer that question, Mr. Littman.

Q. It is your testimony that the investor in natural gas pipe line companies' stocks would require an earnings-[fol. 8372] price ratio of 14%? I am referring to common stock. Is that correct?

Mr. Baldridge: I do not think you properly characterized that. There is some more to it. He said, "given certain other conditions."

Mr. Littman: I would like to have the witness's view on the subject. Do you want me to read your testimony to refresh your recollection, Mr. Drew?

The Witness: I think I have a copy of it here, a memorandum.

By Mr. Littman:

Q. Would you like to refer to it? I think it appears on page 1917 of the transcript.

A. I think I said in my direct testimony that my opinion was that the setup which I then described would be favorably received by the investing public.

Q. Of course, the investing public would receive favorably the highest possible return, wouldn't they?

A. I do not believe I can answer that question.

Q. Well, the investor wants as much return as he can possibly get on his money, doesn't he?

A. Consistent with the risk he is willing to assume in the investment.

Q. Well, you say at transcript 1917, "The rate of earnings on the common would be about 14% after interest, but before serial maturities, and about 7.7% after the serial maturities of the bonds."

Now, isn't the 14% to which you refer by that statement the earnings-price ratio which you feel would be required by the investor in the common stock of Michigan Gas Transmission Corporation?

A. I repeat that, in my opinion, such a setup as I gave which results in 14% of the common stock for serial maturities would be favorably received by the investing public.

Q. This 14% of common stock is comparable to an earnings-price ratio, is it not?

A. No, it is not strictly, for this reason: That the example hypothetical setup which I gave in that direct testimony provided for serial bonds, and those bond maturities would have to be met each year before there were dividends available on the common stock.

Q. Your statement now relates to the 7.7%, does it not?

A. Correct.

Q. I am talking about the 14%. Isn't it a fact that the 14% is frequently called "earnings-price ratio?"

A. I have never heard it called that.

Q. Isn't that the term used by Mr. Coffman?

A. I do not remember seeing the term used by him in his first two volumes.

[fol. 8374] Q. Is that the percentage to which Mr. Coffman referred as the investor's appraisal of the risks of capital in his exhibits?

A. I do not know.

Q. You used his Exhibits 63 and 64—

A. (Interposing) I will try to answer your question if you will show me the volume.

Q. Yes, of course.

Do you want the other volume, Mr. Drew? That is 63 and I can give you 64, if you want it.

(The volume indicated was handed to the witness.)

By Mr. Littman:

Q. Suppose you state on the record what you want to say with respect to Mr. Coffman's exhibits, and your own percent.

A. The 14% to which Mr. Littman has referred is generally termed the "rate of return" on the common stock.

Q. Termed by you as the rate of return?

A. Well, all right, by me. I am willing to restate it, although I think it is used generally.

Q. How is it termed by Mr. Coffman?

A. Off the record—

Q. (Interposing) I would prefer not off the record, Mr. Drew.

A. All right, I will do a little studying.

[fol. 8375] Trial Examiner: Before you make that answer, may I call your attention to your statement on page 1917 in direct testimony, "The price-earnings ratio for the first year would be about 13."

The Witness: Yes, sir; that is just the reverse figure of what Mr. Littman is referring to. The price-earnings ratio, in common investment parlance, is the market price divided by the earnings per share of the stock.

Trial Examiner: Now, he is discussing the earnings-price ratio?

The Witness: Yes.

Mr. Littman: Suppose you define that term?

The Witness: It is your own term, sir.

Trial Examiner: There is an accepted definition, is there not, Mr. Dr w, for that term?

By Mr. Littman:

Q. You just said it was the reverse.

A. As I said, price-earnings ratio is quite a common term used in investment work, but I have never heard the term earnings-price ratio.

Q. Mr. Coffman used it, did he not?

A. I have not found it yet. I was looking for it.

Q. What term did Mr. Coffman use in describing the various percentages which he shows in his Exhibit No. 63 which you used as one of the bases for your study?

[fol. 8376] A. I think this answers the question, Mr. Littman. On page 7 of Exhibit 63, paragraph 3, it states in part:

"The earnings, so determined under 2-A and B, were then divided by the indicated market value of all securities as determined under 1-A and B respectively, and a rate for the period in question was thus obtained."

Q. What does Mr. Coffman call that rate?

A. In paragraph 4, he states, in part, as follows:

"Having determined in the manner described above the investor's appraisal of the risks of capital employed in each company selected," and so forth, by which I take it that Mr. Coffman using the expression "appraisal of the risks of capital" to mean the "rate of return on the market value of securities."

Q. In other words, in order that the record may be perfectly clear, it is your understanding that Mr. Coffman's term "investor's appraisal of risks" is synonymous with your term "rate of return?"

A. Yes, that is correct.

Q. I might state for the purpose of the record that Mr. Coffman, at times, referred to that same rate as the "earnings-price ratio." I think it well that we define our terms at the outset so that we may have no misunderstanding and that is true when related to common stocks.

Mr. Baldridge: Mr. Littman, you said "that is true when related to common stocks." You also mean it is true [fol. 8377] when related to over-all investment of any other character of investment, don't you? I mean, the addition of those last words make it look like you are qualifying the whole of the last preceding sentence.

Mr. Littman: In order that there be no confusion, I am going to ask you, Mr. Drew, to assume that the term "earnings-price ratio" as used by me throughout this cross-examination is the earnings available for the common stock divided by the market value of the common stock. You understand me?

The Witness: Yes.

Mr. Baldridge: And you are limiting it to common stock only?

Mr. Littman: That is right.

Mr. Baldridge: Of course, I may state for the record that Mr. Coffman did not so limit it except in cases where he specifically stated he was limiting it.

Mr. Littman: I cannot agree with that at all.

Mr. Baldridge: That is my understanding.

Mr. Littman: I think you are confusing the record although I appreciate you are trying to assist in clarifying the record.

We have defined the term. That is the way in which we understand Mr. Coffman used it. We understand that [fol. 8378] when Mr. Coffman used the term "investor's appraisal of risk," he was referring to all of the outstanding securities for the company, and when he used the term "earnings-price ratio" he used it in the manner in which I just defined it as relating only to common stock.

Mr. Baldridge: My understanding has been that when he used "earnings-price ratio" it was in relation to all securities of the company taken together, and it may be that I simply short-cut in taking notes on what he said.

Mr. Littman: Of course, where a utility has only common stock outstanding, and no bonds, in that case, the two terms are synonymous.

Mr. Baldridge: Naturally.

Mr. Littman: Very well.

By Mr. Littman:

Q. We understand, do we not, when we use the term "earnings-price ratio," we are going to use it as referable to common stock? A. Yes, sir.

Q. And as we understand Mr. Coffman's exhibit.

In order to earn 14% on the market price of the stock which is selling at twice book value, a corporation would have to earn 28% of the book value of its stock, isn't that correct?

A. I think your arithmetic is correct there, yes, sir. [fol. 8379] Q. Is it a fact, too, isn't it, assuming the conditions which I have assumed?

A. Yes, I think your arithmetic is correct.

Q. Those conditions actually prevail in some stocks, particularly in some natural gas pipe line stocks, do they not?

A. I do not know, sir.

Q. Have you studied the situation in that regard with respect to the common stock of El Paso Natural Gas Company?

A. Not with respect to the relationship of market value to the book value.

Q. Don't you know that the market price of the common stock of El Paso Natural Gas Company is considerably above its book value?

A. No, I did not know it.

Q. Do you know that the same situation prevails with respect to the common stock of Interstate Natural Gas Company and Northern [Natural Gas Company]?

A. No, sir.

Q. You used the first two companies that I have named in arriving at your rate of return?

A. On market value of their securities, yes, sir.

Q. But you made no study of the situation which I have described?

A. I made no study of the relationship between the [fol. 8380] book value of their securities and the market value of their securities, no, sir.

Trial Examiner: Isn't that whole approach fallacious from the standpoint of the Natural Gas Act? I would like to hear from you on that, Mr. Baldrige.

Mr. Baldrige: I think not, Mr. Examiner. Here is what we are confronted with: You are confronted with the problem of finding out how many dollars should be returned to the investment on the rate base. In order to do that, you reach a percentage, then it is a percentage of what? It is a percentage of a certain number of dollars.

Now, the market values, the aggregate market values of all securities outstanding represent a certain sum of dollars. In other words, if \$10,000,000 or \$20,000,000 is being raised, we have to determine what kind of return on that \$10,000,000 or \$20,000,000 is needed in order to enable us to raise it.

Now, what, I take it, is in the Examiner's mind is that that necessarily relates to reproduction cost new. I take it that is the difficulty, is it?

Trial Examiner: Not necessarily.

Mr. Baldrige: I do not think it does.

Trial Examiner: Not necessarily, Mr. Baldrige, but is it not conceivable that the market appraisal of the equity investment in any highly profitable company would give [fol. 838] an utterly false basis and gauge for the determination of a fair rate of return, which is specifically required to be determined under the Natural Gas Act?

Mr. Baldrige: Well, there, Mr. Examiner, I can go into a long series of cases, beginning with the Bluefield case. It has been held, and as far as I know never questioned, that in order to find what a public utility is entitled to receive, you have really two tests. The first is, you must give it a return which is not confiscatory; secondly, the courts have repeatedly said that the mere fact that a return is not confiscatory does not mean that it is necessarily reasonable.

I can remember one Commission said, "The margin between the two rates of return is between one and one-half percent and two percent." That is after you pass the line of confiscation, in order to reach the line of reasonable-

ness you have to add one-half percent, or two percent, somewhere between those two.

Another Commission, I recall, called it one-half of one percent.

Trial Examiner: Yes, but, Mr. Baldrige, you are not driving at the point that I have in mind. The testimony of Mr. Drew is that he has not taken into account book value which, in the sense it was used, indicates an actual investment. He has taken into account the market appraisal [fol. 8382] of the value, the investor's appraisal, if you will, of the value of the company.

Now, we are confined here to, perhaps, in the construction that the Commission has placed on the Natural Gas Act, a consideration of the actual cost. Aren't we dealing with entirely different factors when we take the investor's appraisal of the value of property?

Mr. Baldrige: No, not necessarily, because the aggregate of the market value is an actual sum of money which you raise by going to investors, \$20,000,000, we will say, by offering to those investors something they are willing to buy. You may have that all in the form of common stock, you may have that in, partly, bonds and partly common stock, or you may have bonds, preferred stock and common stock, but you do not actually raise that money unless the investors are willing to take it at that rate or at the several rates which the market then shows.

Now, the value of the market appraisal, I take it, is this: In the case of every company, by multiplying its outstanding securities by the respective market prices, you reach a definite sum of money which you can say is the money which at that time you may consider as being raised in the market.

Trial Examiner: Now, just to get to the point of this, I did not ask this question to provoke discussion. I am [fol. 8383] seriously concerned about the relevancy and value of the testimony of this witness because he knows the investment and he applies a very definite rate of return to an utterly indefinite and unascertainable base.

Mr. Baldrige: I do not think the base is unascertainable in this case, Mr. Examiner. If you look at his direct

testimony, he used the words "actual investment or market value."

Trial Examiner: He was asked by the Chairman of the Bank or rather, by Mr. Green, who has referred to Mr. Drew by the Chairman of the Bank, to give an opinion as to the question of "What rate of return should a company like the Michigan Gas Transmission Corporation earn on its invested capital or fair value in order to be able to finance by public offering of securities?"

Mr. Littman: And he defined that term as the market value of the securities, and that cannot be ascertained in this case. Nobody knows what it is.

Mr. Baldridge: If I may be permitted a minute, I think from the standpoint of a man who is not in the utility business, the term "book value" is one which is extremely misleading. Those of us who have dealt with industrial corporations have found time and time again that book value has no relationship to the actual investment made. Perhaps some of the stock is sold at a premium, perhaps it [fol. 8384] is written down, perhaps it is written up. There are all kinds of factors that enter into the picture. What is important is the actual money that either would go into the enterprise today, if it were necessary to refinance today, or if we are not permitted to show that, at least the amount of money that actually was paid into the enterprise.

Now, I think that one way of estimating the amount of money paid into an enterprise, when you do not have all the facts showing your original investment, is to take the aggregate of the market value of securities, although that necessarily is related to the time when that value is taken, obviously.

Trial Examiner: Mr. Baldridge, we have the cost in this case. We have the actual investment; we do know that from exhibits.

Mr. Littman: It is one of the definite things that we have in this case.

Trial Examiner: The book value in this case means exact dollars.

Mr. Baldridge: I do not think he has been asked a question in that form yet, Mr. Examiner. I have been listening to the cross-examination and I think what the witness has been feeling is that he cannot tell whether the book value, as set up, represents something in the nature of cash actually had to be rated, or was rated.

[fol. 8386] By Mr. Littman:

Q. You testified on direct examination at Page 1913 of the transcript that your bank, as a general policy, has not purchased natural gas pipe line securities for trust accounts, did you not? A. Yes, sir.

Q. However, you state that your bank has bought and does own in trusts a moderate amount of gas distributing company securities, is that right?

A. Yes, sir.

Q. What kind of gas distributing companies do you refer to by that statement?

A. Artificial, natural and mixed distributing companies.

Q. What are the proportions, generally, as among the three types? A. I have no idea.

Q. Is there any particular reason why your company [fol. 8387] has not purchased natural gas pipe line securities other than that stated by you in your direct testimony? What I have in mind is whether your company is limited in its purchase of natural gas pipe line securities by laws regulating trustees?

A. The Illinois statutes do not exclude natural gas pipe line securities.

Q. Do they exclude common stocks?

A. Yes, but I should add, if I may, that in a great many of our trusts, we are not limited in our investment policy to statutory investments.

Q. However, you do administer certain trusts which are under the statutory prohibition against the purchase of common stocks? A. That is correct.

Q. You know, do you not, that large life insurance companies have made heavy investments in natural gas company bonds?

A. I assume that they do. I do not recall seeing in the portfolios of insurance companies natural gas pipe line bonds, but I cannot say.

Q. You cannot give an answer one way or another?

A. No, sir, I cannot say that they do or do not.

Q. Does your bank purchase natural gas pipe line company bonds? A. Not on its own initiative.

Q. Insurance companies are strictly regulated as to [fol. 8388] investments, are they not?

A. I believe they are, in practically all States.

Q. You know, do you not, that banks have made loans to natural gas companies at very low interest rates?

A. I suppose they have in recent years. I do not happen to know of any of my own knowledge.

Q. You did not investigate that? A. No, sir.

Q. When I spoke of low rates, I meant rates as low as 2 percent or 1½ percent. You are not acquainted with the fact that banking institutions in this country have, from time to time, made large loans?

A. I suppose they have.

Q. Has your bank made any loans to natural gas pipe line companies?

A. Not to my knowledge in recent years, at any rate.

Q. Have you made any investigation of the capital structure of Panhandle Eastern Pipe Line Company?

A. No, I have not.

Q. Do you know something about its bonds and long-term debt?

A. I cannot say that I am familiar with its capital structure.

Q. Do you have a copy of Exhibit 64 with you?

A. No.

[fol. 8389] Q. I hand you a copy of Exhibit 64 and refer you to Appendix C, Page 131. You observe, do you not, Item (c) under the heading, "Indicated Market Value of Capital" reading, "Serial Notes, A, B, C and D 0.75-1.50% Due 4/1/42-45" in the amount of \$5,000,000?

A. Yes.

Q. You know, do you not, that that amount represents a bank loan to Panhandle Eastern Pipe Line Company?

A. I see under the explanation that it was sold privately to several banking institutions.

Q. You are referring to Footnote C which reads as follows:

"Sold privately in January, 1941, at 100 to several banking institutions."

A. Yes.

Q. However, your bank does not deal—

A. (Interposing) So far as I know, we have not participated in that type of loan.

Q. Do you happen to know whether the Harris Bank & Trust Company of Chicago, the city in which your bank is located, does make such long-term loans?

A. No, I have no knowledge of that.

Q. Then you have not, in the course of your business and in the course of your own duties had any extensive experience with natural gas pipe line company securities or companies, have you?

[fol. 8390] A. Certainly not extensive, no, sir.

Q. Well, to what extent, if any?

A. As I said in my direct testimony, we have not, as a general policy, purchased but we have, from time to time, I believe, owned them in trust, the securities I am talking about, of natural gas pipe line companies. I cannot say offhand at the present time what securities of that character that we own at the present time but I am certain, if any, it is a small amount.

Q. When you did have them, they were in small blocks, were they not?

A. They were in small blocks, yes, sir.

Q. I note that in your direct testimony you stated that in the course of your study, you placed certain reliance upon information contained in Standard & Poor's published pamphlets, "Industrial Surveys" and "Security Markets." Is that correct?

A. Yes, sir. I also mentioned Moody's Manual in that same statement, I believe.

Q. I did not mean that that was the only source of your information. I meant that I understood you to state that that was one of the sources upon which you relied. Is that right?

A. Well, which I used, I should rather say than "relied".

Q. In your opinion, is the natural gas industry the best situated of the various divisions of the utility industry?

[fol. 8391] A. No, it is not.

Q. Is it better or worse than manufactured gas utilities?

A. From an investor's standpoint, I would say that natural gas securities are less desirable than those of artificial gas.

Q. Are they less favorable than the securities of traction companies?

A. I dislike to generalize on that question because I think there is such a wide variation among the companies in each group that I would hesitate to answer that question directly.

Q. Would you say that the natural gas industry is better situated than the electric industry?

A. No, I would not say so.

Q. Would you say that the natural gas industry is better situated than water companies?

A. In that comparison also, I would hesitate to reply to that question without having a more direct comparison by companies.

Q. However, you are certain that the natural gas industry is not as well situated as the manufactured gas industry, is that correct?

A. That is my opinion.

Q. I want to read you from Standard & Poor's "Bond [fol. 8392] Investments" dated September 6, 1941. The excerpt which I shall read appears on Page 612 under the heading "Gas Company Bonds. Natural gas companies in superior positions to manufactured gas units."

"The natural gas industry is probably the best situated of the various divisions of the utility industry at this time. It will benefit materially from rising general industrial activity and operating expenses are largely fixed. Thus, even with excess profits taxes, any decline in profits should be held to moderate proportions.

"The manufactured gas industry, on the other hand, is in a relatively unfavorable position. Its revenues will benefit little from rising industrial activity and rising operating costs will be adversely affected. A continued decline in profits is likely in this industry."

Did you read this statement in connection with your investigation?

Mr. Baldridge: Mr. Littman, may I ask the date of that?

Mr. Littman: September 6, 1941, which is at about the time Mr. Drew made his study for purposes of this investigation.

The Witness: I may have seen it, I do not remember specifically.

By Mr. Littman:

Q. One of the sources of your data and information was [fol. 8393] Standard & Poor's pamphlet, was it not?

A. That is correct.

Q. Do you consider it reliable?

A. The purpose for which I used Standard & Poor's was to obtain factual matter and not opinion.

Q. Isn't what I read a fact?

A. It is my opinion that it is not a fact, in the long-term view.

Q. Do you agree with this statement that I read from Standard & Poor's pamphlet?

A. I think it may be true as applied to a short interim period here.

Q. And it may be true as applied to a long period?

A. I believe not.

Q. The writer, as I hand you the article, does not limit this statement to any interim period?

A. I thought he said "at this time".

Q. Well, he talks about the future, too, does he not? About what may be expected in the future?

A. Well, I think if you will permit me, he is referring there to the rising armament activity, the rising general industrial activity because of rearmament and defense industries and it is my opinion and certainly my hope that that will not go on very much longer.

Q. What will not go on very much longer?

[fol. 8394] A. (Continuing) Several years perhaps. This rearmament and war industry.

Q. But it is your opinion that so long as the rearmament and war industry goes on there is a bright outlook for the natural gas pipe line industry?

A. No, I would not make it that strong. I would say there may be.

Q. In all probability there will be. Is that what you say?

A. I would not say that.

Q. These statements are intended for investors, are they not? These statements of opinions in Poor's?

A. They are intended, I believe, for buyers of securities. I would be a little careful how I used the word "investors" because it depends on the definition, and what I mean by that is simply this, that an individual with his own funds is perhaps justified in buying certain securities that institutions including trust institutions would not be justified in buying.

Q. Well, certainly, a prospective purchaser of securities would naturally be led to believe by this statement that the natural gas industry is probably the best situated of the various industries in the utility business at this time, would you not?

A. I cannot say what he would believe, that is what the article says.

[fol. 8395]- Q. Are you familiar with the recent refinancing by Panhandle Eastern Pipe Line Company for the purpose, among others, of acquiring Michigan Gas Transmission Corporation?

A. I am not familiar with the details of the financing. I observed some weeks ago that the financing was being undertaken. Prior to that, I believe I had seen a press notice that the Michigan Gas Transmission Corporation was being sold.

Q. Well, you know, do you not, that within the past month Panhandle Eastern Pipe Line Company issued \$10,000,000 of first mortgage and first lien 3 percent bonds and 150,000 shares of 5.6 percent cumulative preferred stock, having a par value of \$100 per share?

A. Well, as I say, I did not remember the details of the transactions.

Q. But you heard about it?

A. Yes.

Q. You, also, heard, did you not, that no difficulty was experienced at all in this financing and the financing was readily accepted?

A. No, sir, I had not heard that.

Q. You know the bonds sold at the yield of 3 percent, do you not?

A. I do not recall the yield at the offering price.

Q. Didn't you investigate that subject at all, namely, the subject of the recent refinancing by Panhandle Eastern [fol. 8396] Pipe Line Company?

A. Not investigated, no, sir, I did not.

Q. Don't you think that this recent refinancing program has a bearing upon the rate of return to which Michigan Gas Transmission Corporation is entitled for the purposes of this proceeding?

A. Well, I cannot see the connection.

Q. You cannot see the connection? A. No.

Q. Do you know that Panhandle Eastern Pipe Line Company has recently acquired all of the outstanding stock and securities of Michigan Gas Transmission Corporation?

A. I understood that was a part of the purchase.

Q. Now, you used, for purposes of your study, certain earnings and rates of earnings earned by four other natural gas pipe line companies, did you not? A. Yes, sir.

Q. Will you name them, please?

A. El Paso Natural Gas Company, Southern Natural Gas Company, Memphis Natural Gas Company and Interstate Natural Gas Company.

Q. Did you consider those data relevant and material to the issue of determining the proper rate of return to which Michigan Gas was entitled? A. Yes, sir.

[fol. 8397] Q. But you do not consider the flotations by Panhandle Eastern Pipe Line Company within very recent days material to that issue?

A. The issuance of the Panhandle securities came several months after the preparation of my study, which I covered in my direct testimony.

Q. I understand that, Mr. Drew, but I understood your testimony to be here a minute ago that you cannot see the connection between the recent refinancing by Panhandle Eastern Pipe Line Company and the issue before us, namely, the issue of what is the fair rate of return. Wasn't that your testimony?

A. Well, I will correct that testimony, if I may. I think it has some relation, about the same relation as these other companies, perhaps, in an average way.

Q. Not any more relation than those of the other companies?

A. I would not think so.

Q. You have testified at Page 1916 of the transcript that you utilized the Dow-Jones industrial stock average in arriving at your $8\frac{1}{2}$ percent rate of return for Michigan Gas Transmission Corporation. Isn't that correct?

A. That is not quite the full story. I used the companies whose common stocks are included in Dow-Jones industrial average and to those 30 companies I applied the same method which I had used in arriving at an average rate of return on market value of invested capital [fol. 8398] for the natural gas companies.

Q. You consider the Dow-Jones industrial stock average a reliable guide, do you not?

A. Well, I think it is the guide which is most closely followed by investors.

Q. In other words, it is reliable, in your judgment, for purposes of this proceeding?

A. I think it is useful in a proceeding of this kind, yes.

Q. Well, how useful, quite useful?

A. Yes, quite useful.

Q. Is the Dow-Jones index of industrial stock prices the most reliable index?

A. Well, I think that is a matter of opinion.

Q. It is at least one of the most reliable?

A. It is one of the best regarded, certainly.

Q. Now, the Dow-Jones industrial stock average is an average of 30 active stocks of representative companies in diversified industries, is not that correct?

A. Yes, sir.

Q. Would you expect the earnings' price ratios on the Dow-Jones stocks to be higher on the average than the earnings' price ratios on public utility stocks?

Mr. Baldridge: Mr. Littman, I am afraid I have to object to that question if you are going to limit it to common stocks because of the very obvious fact that common stocks [fol. 8399] play an entirely different proportion in the total investment of almost any company.

Mr. Littman: Well, that is what this witness used, Mr. Baldridge. I am asking this witness about what he did. He used the average of these 30 industrials, you see, that is, the average of the common stocks of these 30 industrials. I am not talking about something I did, I am talk-

ing about something the witness did. Are you objecting?

Mr. Baldridge: I do not know that he testified exactly that.

Mr. Littman: There is an objection pending to what I consider a perfectly proper question.

Trial Examiner: Is Mr. Littman's interpretation of your testimony correct, Mr. Drew?

The Witness: I would, again, amplify what he has just said, to this effect, that I used the companies represented in the Dow-Jones industrial stock index and applied to those companies the market values, market prices of their bonds, preferred stocks and common stocks in arriving at the figure that I gave in my direct testimony.

By Mr. Littman:

Q. In other words, your study of Dow-Jones was confined to common stocks?

A. No, sir, that is exactly what I am trying to say, it included the bonds and the preferred stocks of the companies represented in the Dow-Jones index.

[fol. 8400] "Mr. Baldridge: May I, in that case, repeat my objection, Mr. Examiner, because I do not think the question has relevancy?"

Mr. Littman: Will you please read the question again?

(Whereupon, the question indicated was read as follows:

"Q. Would you expect the earnings' price ratios on the Dow-Jones stocks to be higher on the average than the earnings' price ratios on public utility stocks?")

Mr. Baldridge: The witness has testified that he did not use simply the Dow-Jones stocks but used 30 companies and various kinds of stocks of those companies.

Mr. Littman: Have you seen this witness' working papers? I am sure if you took a look at them you would withdraw your objection.

Mr. Baldridge: I have heard his testimony, I have just heard his testimony.

Trial Examiner: I think the witness is entitled to answer the question in his own way. This does not necessarily require a yes or no answer and Mr. Drew may explain the factors that he wishes to discuss.

Mr. Littman: Will you please answer the question?

The Witness: Shall I answer the question, Mr. Examiner?

Trial Examiner: In your way, Mr. Drew.

The Witness: I would expect the earnings' price ratio of utility common stocks to be somewhat higher than that [fol. 8401] ratio on industrial stocks and I predicate my opinion on that score on Barron's, The National Financial Weekly, of February 23, 1942, Page 17, which shows the yields on the Dow-Jones averages for the previous week and it shows that the yield on the 30 industrials was 7.15 percent and the yield on the average on 15 utilities was 8.56 percent.

Now, I believe that those figures represent dividends divided by market prices, but I think I would find that the earnings divided by market prices would be in somewhat the same relationship.

By Mr. Littman:

Q. You have not investigated that, however, sir?

A. No, I have not.

[fol. 8404] Mr. Littman: Mr. Drew, did you use your working papers in assisting you to arrive at your rate of return to which you are testifying in this proceeding?

[fol. 8406] By Mr. Littman:

Q. What was the aggregate market value of the securities of the 30 industrials comprehended by the Dow-Jones averages?

A. The corrected figure is \$17,244,000,000.

Q. What do you mean by "corrected figure"?

A. I should like to explain that by saying after I got back to my office from the hearings in Washington, I had the table rechecked and I found one error in the third item, the American Smelting & Refining Company.

Q. That was an error of about \$74,000,000, wasn't it?

A. It was an error of \$74,500,000.

Q. \$74,500,000? A. That is correct.

Q. \$74,250,000 to be exact, isn't it?

A. Yes, that is right. It was in the preferred stock.

Q. Of the American Smelting & Refining Company?

A. Of the American Smelting & Refining Company in which case, the man who prepared this for me put down the figure of 500,000 which is the number of shares of preferred stock outstanding but unfortunately, he put in front of that "\$", so that he got a result there of \$750,000 which is obviously out of line and we have corrected that.

As a matter of fact, it makes very little difference in the net result even though \$74,000,000 is a lot of money. The aggregate amount is so large that the effect of the change [fol. 8407] itself is small.

Q. Suppose you give us the corrected figures to be inserted in your working papers. I shall go across your working papers for American Smelting Company and ask you to give me the corrected figures.

In the first column you show common stock—2,191,669 shares?

A. Yes, that is correct.

Q. Then you show the price to be \$36?

A. No change there.

Q. Producing a market value of \$78,900,984, is that right?

A. That is correct, yes, sir.

Q. Now, going to the columns headed "Preferred Stocks, Bonds and Other Securities", you have 7 percent cumulative preferred in the first column; in the second column, your working papers show \$500,000 as the par value of the preferred stocks.

Now, what is the correct figure to be placed there instead of that?

A. 500,000 is correct but it is shares and not dollars.

Q. How many dollars belong there instead of the 500,000 that you show?

A. 500,000 shares is what it should be.

Q. That should be 500,000 shares?

[fol. 8408] A. That is correct.

Q. The dollar sign should be removed?

A. Yes, sir.

Q. Now, the next column shows the price at November 12, 1941, to be \$50, does it not? A. Yes, sir.

Q. That is correct? A. That is correct.

Q. And the next column, and this is the one that has the error, shows the value to be \$750,000. What figure [belong] in that place. A. \$75,000,000.

Q. The next column of your working papers shows "Total market value", \$79,650,084. What is the correct figure to be inserted?

A. That should read \$153,900,084.

Q. Instead of \$79,650,084?

A. That is correct.

Q. Are the figures that appear in the next column, "Estimated 1941 Net Income after Taxes and Depreciation Available for Interest and Dividends" are those figures all right? They are \$9,895,000 to \$10,995,000. Are those correct?

A. There has been a change made in here. Those two figures should be, \$13,360,000 and \$14,460,000.

Q. Where did you get that information, from Standard [fol. 8409] & Poor's?

A. Those two figures come from an estimate of Standard & Poor's for the 1941 earnings after taxes.

Q. And depreciation?

A. And depreciation, and to those estimates of Standard and Poor's, we have added back the dividends on the preferred and the interest, if any, on the bonds.

Q. Now, in the final column, your working papers show, "Return on market value" as 12.42-13.80 percent. Those figures are in error, are they not? A. Yes.

Q. What are the correct figures?

A. The corrected figures are 8.68 and 9.39.

Q. Percent? A. Percent.

Mr. Baldridge: I would like the record to show that the correction that has just been made in the working papers relate to matters that have not been offered and introduced in evidence.

The Witness: May I say just a word more?

Mr. Littman: Yes.

The Witness: In my direct testimony, I said that the average of the ratios of the net earnings to market value of capitalization was 9.6 percent. That should be changed to read 9.5 percent.

[fol. 8410] By Mr. Littman:

Q. Now, that change was occasioned by reason of the corrections which you just read into the record?

A. A tenth of one-percent occasioned by \$74,000,000 error, because the grand total is so large, the error made little difference. The 8.7 percent which I gave in my direct testimony is approximately correct. The actual percentage corrected is 8.66.

Q. As you stated a moment ago, the active market value of the 30 industrials in the Dow-Jones average was \$17,244,000,000, is that right?

A. \$17,244,000,000, yes, sir.

Q. What was the net income for those 30 Dow-Jones industrials for the year 1941?

A. \$1,494,000,000.

Q. As of what date did you take the market value figure of \$17,000,000,000-odd which you read a moment ago?

A. November 12, 1941, in so far as they were available.

Q. You have just stated that you found from your working papers that the arithmetic average of the ratios of net income to market value of capitalization for these 30 Dow-Jones industrials was 9.5 percent. Is that right?

A. Yes, sir.

Q. Now, that is an arithmetic average, isn't it?

A. Yes, sir.

[fol. 8411] Q. And the weighted average was 8.7 percent? A. Yes, sir.

Q. Which of these averages would you consider the more reliable?

A. I think the weighted average is probably the better one to use.

Q. When you use the weighted average that, of course, takes into account and makes proper compensation for the differences in the size of the various companies, doesn't it?

A. Yes. A small company with a very high rate of return would be more or less ironed out in this weighted average.

Q. And, therefore, you consider the 8.7 percent a more truly representative average, do you not? A. Yes, sir.

Q. Now, the figures which you have just read with respect to market value and earnings relate to the total securities of these 30 industrials, that is, all of their long-term debt, preferred stocks and common stocks, isn't that correct? A. Yes, sir.

Q. Can you tell us from your working papers—and I am quite sure you can—the total market value of the common stock of these Dow-Jones industrials—do you want me to read the figure and then will you check it?

[fol. 8412] A. If you wish.

Q. May I ask approximately how long it would take you to check the figure?

A. Well, I have the figure right here.

Q. You have the figure there, I am sorry; \$13,812,318,882?

A. That is the figure, yes, sir.

Q. What is the total gross income on that common stock as shown by your working papers?

A. I do not have any such figure available. It could be ascertained by the addition of that column 16.

[fol. 8413] By Mr. Littman:

Q. Now, the figure which I am about to read will represent the total gross income on the common stock of the 30 Dow-Jones industrials as taken from your working papers and as arrived at by deducting the total annual interest on bonds and dividends on preferred stock from gross income of \$1,430,079,140 which is the figure before adjustment for the error. Do you follow me?

A. Yes.

Q. Now, the figure which we would like to have you check and assume for the time being is correct is \$1,367,411,573—I will read that again, I am not accustomed to dealing with such large dollar amounts. If it were M.e.f., I would probably get along better—\$1,367,411,573.

You understand how we arrived at this from your working papers, do you not?

A. Yes.

Q. And the method we have used is the correct method, is it not?

A. I am just feeling my way on that.

Mr. Baldridge: The right method of getting what, Mr. Littman?

Mr. Littman: The right method of getting the earnings available for common stock.

The Witness: I see quite a wide discrepancy there in [fol. 8414] just a quick check. I would like to go through it a little more completely.

By Mr. Littman:

Q. Mr. Drew, during the recess have you had an opportunity to study the method which I suggested for the determination of the amount of income available for the common stock?

A. Yes, sir.

Q. And you agree that that is the correct method to be used to arrive at that amount from your working papers?

A. I believe it is.

Q. And you will check the amount, will you not, of \$1,367,411,573 of gross income on the common stock, will you?

A. Yes.

Q. Assuming that the figure that I read is correct, what was the earnings-price ratio on the Dow-Jones common stocks as of November 12, 1941?

A. About 10 percent.

Q. 9.9 would be a little more exact?

A. I have not calculated, that is one thing I did not do, but I can see that it is about 10 percent.

Q. Well, suppose you accept our figure of 9.9 percent. [fol. 8415]

A. Yes.

Trial Examiner: Subject to correction.

Mr. Littman: Yes.

By Mr. Littman:

Q. What date in 1941 did you use for the market price of the Dow-Jones industrials for purposes of your study?

A. November 12, 1941.

Q. I hand you a copy of the "Commercial Financial Chronicle" dated November 18, 1941, and ask you to state the Dow-Jones average for these 30 industrials for November 12, 1941. You can check from that "Chronicle".

A. 115.44.

Q. 115.44. Now, that relates to the common stock, does it not?

A. Yes, sir.

Q. Of these 30 industrial companies which you have heretofore referred to?

A. That is correct, yes, sir.

Q. I hand you a copy of Standard & Poor's securities statistics and ask you to state what was the average of the Dow-Jones 30 industrials' common stock during the year 1936.

Mr. Culton: May I inquire, for information, whether or not those were the same stocks in 1936 and in 1941?

By Mr. Littman:

Q. Are the industries comparable?

[fol. 8416] Mr. Culton: That is not what I asked. I asked, for information, whether or not it was the same stocks.

By Mr. Littman:

Q. There were 30 industrials in 1936?

A. Yes.

Q. Were they the same industrials in 1936?

A. I cannot answer that question.

Q. Well, if they are not identical, they have been made comparable strictly by the Dow-Jones average, have they not?

A. I believe they are comparable.

Q. Will you please read the figures?

Mr. Baldrige: I object to that on the ground that nothing in the witness's testimony relates to the year 1936.

Trial Examiner: You may answer.

Mr. Baldrige: Exception.

Trial Examiner: Exception noted.

The Witness: The high of the Dow-Jones industrial average for 1936 is given in this publication as 184.9 and the low, 143.7.

By Mr. Littman:

Q. That would make an average of 164.30, would it not?

A. It would be close to that figure, I am sure. Do you want me to calculate it?

Q. Suppose you calculate it. Then we won't have to [fol. 8417] assume too many figures.

Mr. Culton: That is an arithmetical average, is it?

Mr. Littman: Adding 184.9 to 143.7, dividing by 2.

The Witness: 164.3.

Mr. Culton: It is an arithmetical calculation.

By Mr. Littman:

Q. You have no reason to doubt the reliability of the figures which you have just read which were published by Standard & Poor's?

A. No, I have no reason to doubt it.

Q. As a matter of fact, they are used in the industry and by you every day, are they not?

A. Yes, sir.

Q. Now, assuming, Mr. Drew, that an investor had purchased \$164,300 worth of common stock in these 30 industrials in 1936 at the average prevailing price in that year, his investment would have declined to November 12, 1941, would it not?

A. Yes.

Q. And what would be the amount of the decline in market value of the securities which this 1936 investor purchased in the 30 industrials as between 1936 and November 12, 1941?

A. Well, if the investor bought the 30 stocks in the same proportions as those stocks are used in the industrial averages, then I should say that his investment today [fol. 8418] would be worth approximately \$115,440.

Q. You mean as of November 12, 1941?

A. As of November 12, 1941.

Q. Rather than today?

A. Yes.

Q. And you caught precisely the point I am attempting to reach, that is the theoretical purchase equally and ratably throughout the 30 industrials.

Now, what is the amount of loss that this 1936 investor has sustained on his investments in 1936 of \$164,300?

A. \$48,860.

Q. Now, let me see if I correctly understand you.

Trial Examiner: What percentage is that, before you leave that?

The Witness: About 30 percent, sir.

By Mr. Littman:

Q. Now, let's examine the predicament of the 1936 investor, Mr. Drew, who invested his 1936 dollars in these 30 representative industrials. It is a fact, is it not, that he invested in 1936 \$164,300 and he made that investment; of course, with 1936 dollars, did he not?

A. Yes, sir.

Q. No question about that?

A. No.

Q. And on November 12, 1941, he had sustained a loss [fol. 8419] in his investment of \$48,860, had he not?

A. Yes, sir.

Q. And his present investment is worth \$115,440 in present-day dollars, is it not? Is that right?

A. Yes, sir.

Q. Now, suppose that investor had invested in the common stock of Michigan Gas Transmission Corporation in 1936, which was the year in which it was first organized. He would not have suffered any loss on his investment in common stock, would he?

A. I cannot answer that question.

.

By Mr. Littman:

Q: Let us look at it this way, what would the investor have received by way of a dividend since 1936 on his investment in the common stock of Michigan Gas Transmission Corporation? 89 percent, isn't that correct?

A. I cannot answer that question.

Q. Well, in your determination of this rate of return estimate, didn't you investigate the amount of dividends paid by Michigan Gas Transmission Corporation?

[fol. 8420] A. No, sir.

Q. And you cannot tell us whether the investor in the common stock of Michigan Gas Transmission Corporation in 1936 still has all of his present investment?

Mr. Baldridge: Judged by what criterion?

Mr. Littman: By the criterion of the sale by Michigan Gas Transmission Corporation to Panhandle Eastern Pipe Line Company here the other day, which sale price was measured by the net investment of the investors in the property. Does that answer your question, Mr. Baldridge?

Mr. Baldridge: Not entirely. Of course, the question I asked you, yes.

Trial Examiner: Of course, you must not assume that Mr. Drew is familiar with the testimony that has been received in evidence in this case the last few days. There are certain answers that have come into the record here by way of direct testimony with which you are not familiar, Mr. Drew, and when you encounter those, you are at liberty to call attention to them.

The Witness: I think I could answer your question fairly, perhaps, by saying this, that if Michigan Gas Transmission Corporation had had common stock publicly owned upon which there was an active market, an investor who bought that stock at average prices of 1936 would, in my opinion, today have approximately the same loss, paper [fol. 8421] loss, as is shown in these industrial stocks.

By Mr. Littman:

Q. I see. Now, if that investor has been allowed or is allowed a reasonable return upon his original investment from 1936 down to today, he would be better off, wouldn't he, than if he had been allowed a return on the purported market value of the stock through the years? Isn't that right?

The Witness: I would like to have you ask that question again. Perhaps you will read it.

Mr. Baldridge: I will have to point out, Mr. Littman, that that question is a little misleading because you are mixing two things, you are mixing the entire investment in the company, including all kinds of securities with investments in common stock alone.

Mr. Littman: Do you understand the question?

The Witness: I would like to have it read, please?

Trial Examiner: Read the question.

(Whereupon, the question beginning at Line 3 of this page was read by the reporter.)

The Witness: I do not think I can answer that question.

By Mr. Littman:

Q. What don't you understand about it?

A. I do not understand what you mean by an investor being allowed a return.

Q. If this Commission allows a fair rate of return on [fol. 8422] the original investment in this property from 1936 down to the present day, it is a fact, is it not, that the investor still has his investment today and has received a reasonable return from 1936 down to today, isn't that a fact?

A. Well, it seems to me that you are confusing a return allowed to the company and the return which the individual investor is going to receive or did receive during that period. I cannot correlate the two things very well.

Q. What return are you talking about when you speak of 8½ percent? Are you speaking about the return to the company or are you speaking about the return to the investor?

A. I am speaking about the return represented by the earnings of the company divided by the market, the aggregate market value of its securities.

Q. Well, who gets the 8½ percent, the company or the investor, according to your theory?

A. Well, it is not a question as to who gets it, it is a question of the rate of earnings necessary for a company to be able to finance itself publicly.

Q. Are you asking here for an 8½ percent return on 100 percent of the investment in 1936 or on 70 percent of the investment in 1936?

A. I am talking about an 8½ percent return as the net earnings divided by the aggregate market value of the securities of the company.

[fol. 8423] Q. As of November 12, 1941?

A. As of November 12, 1941.

Q. And that, according to your testimony, represented only 70 percent of the market value of those securities in 1936. Is not that right?

A. No, sir, I did not testify to that.

Q. Well, you said that that was what you would expect, did you not?

A. I said I would expect the common stock of a public utility company like the Michigan Gas Transmission Corporation outstanding in the hands of the public and actively traded to have declined in price about the same from the average of 1936 to November 12, 1941.

By Mr. Littman:

Q. So that confining ourselves to common stock, you are asking for a return on only 70 percent of its 1936 market value?

[fol. 8424] A. Well, if I were dealing with common stock alone, I would raise that 8½ percent.

Q. We understand that, but I would like to have you answer my specific question.

A. But you are tying me down to 8½ percent on common stock.

Q. I have not said anything about 8½ percent in my question.

Will you read my specific question?

(Whereupon, the question indicated was read by the reporter as follows:

"Q. So that confining ourselves to common stock, you are asking for a return on only 70 percent of its 1936 market value?"

The Witness: Well, I am not asking for any return. I will have to state again that I think a public utility com-

pany like Michigan Gas Transmission Corporation, having common stock outstanding in the hands of the public, fairly actively traded, would probably have declined in market value in about the same proportion, perhaps a little more, than this Dow-Jones industrial average.

By Mr. Littman:

Q. What you are saying is that using 1936 as an index of 100, for market value of the common stock, it would have gone down to 70 in 1941, at November 12, isn't that correct?

[fol. 8425] A. I repeat my previous statement.

Q. Is that correct?

A. I think that is substantially correct, yes, sir.

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By Mr. Littman:

Q. Now, going back to your original proposition of the 1936 investor who had invested his 1936 dollars in \$164,300 worth of the 30 industrials' common stocks, assuming that that investor held those shares down to and including November 12, 1941, his earnings-price ratio would not be 10 percent based upon his original purchase price, would it? A. No, sir.

Q. It would be something considerably below 10 percent, is that right? A. Yes, sir.

Mr. Culton: May I inquire if that would be the same figure if the purchase had been made in November, 1929? [fol. 8426] That would be a different situation, wouldn't it? Do you recall enough about what the market conditions were in 1929?

The Witness: Yes, it was chaotic. Of course, it did not reach its low until sometime in 1932.

By Mr. Littman:

Q. What would the 1936 investor's earnings-price ratio be on that basis, bearing in mind that the earnings as of November 12, 1941, amounted to 10 percent of the then-market value?

A. Well, I think it would be approximately 30 percent lower return.

Q. That would be something like 6.96 percent?

A. About 7 percent, I should think.

Q. Now, the 6.96 percent is the earnings-price ratio today of the man who had invested his money in 1936 in the common stock of these 30 Dow-Jones industrials, isn't that right? A. Using 1941 earnings.

Q. Using 1941 earnings and the return upon which the 6.96 percent is computed is in today's dollars, is it not?

A. Well, its percentage, its percentage. It is not in dollars. The income is payable in today's dollars, yes.

Q. The income was payable in dollars that would buy the amount of bacon and eggs that today's dollars will buy, is that right?

[fol. 8427] A. Yes, sir.

Q. Now, the investor has suffered a loss, you say, of \$48,000-odd since 1936, has he not?

A. A paper loss, yes, sir.

Q. Well, he suffered a loss in 1936 dollars, didn't he, in dollars that bought bacon and eggs in 1936?

A. He has not suffered a loss until he sells his stocks. If he were to sell his stocks today, he would have suffered that loss.

Q. Of course.

A. Until he sells it, it is a paper loss.

Q. The paper loss is in 1936 dollars, isn't it?

A. Well, his purchase was made in 1936 dollars and the receipt of sale, if he were to sell as of November 12, would be in dollars of that date.

Q. The only comfort he has is the hope that some day the stock will go up again?

A. Are you asking me if I think that is correct?

Q. Yes.

A. I do not think it is correct.

Q. At any rate, if he wanted to sell those shares on November 12, 1941, he would be out of pocket \$48,860, would he not? A. That is correct.

Q. And those are all 1936 dollars?

[fol. 8428] A. The stocks he would sell would have been purchased in 1936 dollars.

Q. So that his loss would be in 1936 dollars, wouldn't it?

A. I think you could say that, yes.

Trial Examiner: Has some distinction been claimed as to the values of the 1936 dollar and the 1941 dollar?

Mr. Littman: Yes, your Honor, there has been a considerable claim made in this proceeding on that account. I do not know whether Mr. Drew is familiar with it.

Trial Examiner: There have been various references to ascending costs.

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[fol. 8429] By Mr. Littman:

Q. Now, let's again examine the predicament of the 1936 investor to whom we have made reference heretofore. His real return on his common stock is down to 6.96 percent, is it not?

A. On his purchase price?

Q. Yes. A. Yes.

Q. Now, he has lost \$48,000 and he has to get that back somehow out of his earnings if he is going to be made whole, isn't that right?

A. I think each investor's position would be different from the other. I cannot write a prescription.

[fol. 8430] Q. How is he going to get the \$48,000 back that he lost if he is not going to get it back out of the 6.96 percent return which he is receiving upon his original investment?

A. Has he sold his stocks now?

Q. No.

A. Then he has not any loss.

Q. He does not feel very good about it though, yet, does he? A. I would not, in his case.

Q. All he has is a vague hope that sometime the stock may go back up, is that right?

A. I think he would have a hope for a later rise in the market value of his holdings, certainly.

Q. It has been your testimony, Mr. Drew, that the capital structure of Michigan Gas Transmission Corporation should be 50 percent bonds which should yield 3½ percent, is that correct?

A. I do not believe I said "should be".

Q. What did you say?

A. I said under present conditions, I believe the most economical method of financing publicly a company like Michigan Gas Transmission Corporation, assuming a total capitalization of \$13,000,000, would be to set up a capitalization of one-half serial bonds and one-half common stock.

Q. What is wrong with my statement? I thought I said [fol. 8431] just that, except in much fewer words.

A. My opinion is, to finish that paragraph, my opinion is that the following setup would be favorably received by the investing public. I did not say the capitalization "should be" what follows.

Q. Do you consider that capitalization fair and proper?

A. Yes.

Q. For purposes of determining the rate of return for this proceeding?

A. I made that calculation, that hypothetical setup, for the purpose, among other things, of testing out the capitalization along the lines suggested to see where we would arrive in the matter of return, earnings divided by market value of capital.

Q. Then you did use a capital structure which comprehended 50 percent of bonds in arriving at your estimate of $8\frac{1}{2}$ percent rate of return, didn't you?

A. My purpose there was more to test out my conclusion rather than to have it contribute to the conclusion.

Q. We want to do a little testing too, and we want to know whether you agree that it is right to test your method by the same test that you used, namely, the use of a capital structure with a 50 percent bond feature.

Now, do you have any objection to that?

A. Not in the least.

[fol. 8432] Q. Do you think it is fair to do it that way?

A. Certainly it is fair, indeed.

Q. Before we do that, you assume a $3\frac{1}{2}$ percent return on the bonds, do you not? A. Yes.

Q. Now, assuming a capital structure having 50 percent of bonds yielding $3\frac{1}{2}$ percent, such a set-up would require earnings of \$1.75 per \$50 of bonds, isn't that correct?

A. Yes.

Q. Assuming that 50 percent of the capital stock was floated through an issue of common stock, which I believe is one of the assumptions you made—

A. (Interposing) You mean 50 percent of capitalization in common stock.

Q. Yes. Now, assuming that 50 percent of the capital were floated through an issue of common stock having an earnings-price ratio of 6.96 percent, the cost of \$50 of such capital would be \$3.48, wouldn't it?

A. For each \$50 of market value of the stock, yes.

Q. Of the market value of the stock, right.

Now, let's go back. We have \$1.75 of earnings requirement for \$50 of bonds and we have an earning requirement of \$3.48 for \$50 of common stock, do we not? I am merely summarizing.

A. Repeating, yes.

[fol. 8433] Q. Is that right?

A. Yes.

Q. What would be the cost of capital per \$100 raised in that manner, expressed in percent?

A. 5.22 percent.

Q. 5.23 percent? A. 5.23 percent.

Q. Now, in this calculation, we have used your interest rate of $3\frac{1}{2}$ percent on the bonds, haven't we? That is the interest rate that you used to test your rate of return?

A. The coupon rate, yes.

Q. And you have used the 6.96 per cent return which the 1936 investor in the 30 Dow-Jones industrials is today receiving upon his 1936 dollars, is that right?

A. That is the figure you suggest, yes.

Q. Yes, and the resulting rate of return indicated is 5.23 percent, is that right?

A. Yes.

Q. You used a coupon rate of $3\frac{1}{2}$ percent on bonds for Michigan Gas Transmission Corporation, is that right?

A. Yes, sir.

Q. Isn't it a fact that Panhandle Eastern Pipe Line Company has, in the year 1941, paid an average rate of 2.74 percent on its outstanding bonds and long-term debt?

A. I have not made that calculation.

[fol. 8434] Q. Well, have you examined Mr. Coffman's exhibit which shows that?

A. Yes, but I do not recall the figure.

Mr. Baldridge: Which exhibit was that in Mr. Littman?

Mr. Littman: In Exhibit No. 65, and, also, I believe Exhibit No. 64.

Mr. Baldridge: The reason I asked is that the witness said he had never seen Exhibit 65.

By Mr. Littman:

Q. I hand you a copy of Mr. Coffman's Exhibit No. 64 and refer you to Appendix C, Page 131, and ask you to state whether it is a fact that Panhandle Eastern Pipe Line Company, as shown on that page, had no long-term debt that exceeded 3 percent in 1941.

A. I believe that is correct, in accordance with this statement.

Q. And it also had some long-term debt that was below 3 percent, isn't that right?

A. Yes,

Q. Does 2.74 sound reasonable or about right to you?

A. That sounds reasonable on the basis of that exhibit.

Q. Well, that is the amount that is shown in this Exhibit No. 65, but inasmuch as you examined his Exhibit 63 and 64 I wanted to show you where it appeared in those latter exhibits.

{fol. 8435} Now, do you know the interest rate on the \$10,000,000 of bonds that were issued by Panhandle Eastern Pipe Line Company in February of 1942 in connection with its refinancing program?

A. Well, I think they were 3 percent bonds, were they not?

Q. Three percent. That is your understanding of it, isn't it?

A. Yes.

Q. Now, you know that the proceeds from those bonds are being used for the purpose of purchasing, at least in part, the securities of Michigan Gas Transmission Corporation, do you not?

A. Yes, that is my understanding.

Q. Now, in view of those circumstances, don't you want to revise your 3½ percent rate for bonds?

A. No, sir.

Q. Do you want to revise your 8½ percent in view of the changed conditions?

A. No, sir.

Trial Examiner: Would it be a fair inference, Mr. Drew, from your testimony, from the statement that you have made, that the financial situation from the standpoint of any future financing has deteriorated instead of being strengthened by the recent change in the ownership of securities?

[fol. 8436] In other words, a very important change in ownership has occurred during the course of your testimony and it is a fair question to ask you whether your conclusion are the same, irrespective of that new ownership.

The Witness: With respect to Panhandle Eastern or Michigan Gas Transmission Corporation?

Trial Examiner: Michigan Gas Transmission Corporation, I assume, is now a wholly-owned subsidiary of the Panhandle Eastern Pipe Line Company. Is that not right?

Mr. Littman: That is my understanding.

Trial Examiner: Does that fact in any way affect the prospective cost of money for capital which the future may require?

The Witness: I should not expect any change on that account, no, sir.

Mr. Lee: Despite the fact that the actual cost of the money and the transaction recently consummated is less than 3½ percent for the bonds?

The Witness: Yes, sir, that is correct.

Mr. Lee: Well, why should not actuality take the place of theory?

The Witness: Well, I think we can refer to actuality [is] this way: At the time that I made my calculations last fall for the direct testimony, in which I referred to the four natural gas pipe line companies, I originally had Panhandle [fol. 8437] Eastern Pipe Line Company in the group, making five in all. I decided that it was better to omit it because it was a related company tied in with the general pipe line system. I will be glad to refer to it now and I have here the calculation which I made at that time, about October 25, 1941, made at the same time that I made the other calculations and on the same basis.

At that time Panhandle Eastern had outstanding 6,250,000 first serial A bonds, 12,000,000 first mortgage 3 percent bonds, which had been offered to the public in January of 1941, and 5,000,000 of serial notes which had been sold at par to bankers in January, 1941.

Then, that was followed by two classes of preferred stock and 807,367 shares of common no par.

Applying market value to the 12,000,000 of bonds and using par value for the serial A bonds and the serial notes and using a price of \$40 per share for the common stock, which seemed fair in view of the fact that in 1940 the price had ranged from $17\frac{1}{2}$ to $41\frac{3}{8}$ and on September 30, 1941, it was $41\frac{3}{4}$ bid,—applying then the \$40 per share to the common stock we came out with a grand-total capitalization of \$68,245,000.

The company reported earnings for 1940 of \$5,714,000 and dividing the one by the other we arrived at an 8.4 percent return of actuality in income divided by the market [fol. 8438] values of those securities, the aggregate market value of the securities as of approximately November 12, 1941.

Trial Examiner: In preparation for this testimony, did you make a similar analysis of Columbia's financial status?

The Witness: No, sir, I did not. This was made on the basis of its being a representative natural gas pipe line company similar to El Paso, Southern, Memphis and Interstate.

Trial Examiner: The reason for the last question was that you seemed to speak with confidence that there is no substantial effect from the change of ownership and I wondered if you had confidence in your own familiarity as a basis for that expression.

The Witness: Well, I must state, Mr. Examiner, that I am not familiar with the details of the financial structure of either Columbia Gas & Electric or Panhandle Eastern.

Trial Examiner: But it is customary, is it not, for changes of affiliations to change financial strength in the market?

The Witness: I do not think it necessarily follows, no, sir.

Trial Examiner: Not necessarily, but I say it frequently occurs, does it not, that a company may be strengthened by new affiliations, for instance?

The Witness: Well, I think that is correct, I think it also could be weakened.

[fol. 8439] Trial Examiner: And in this case you think there has been no substantial effect?

The Witness: Well, based on my limited knowledge of the two companies, I would not expect any change in that regard.

By Mr. Littman:

Q. Mr. Drew, would you be willing to accept as accurate the representations made to the Securities and Exchange Commission with respect to whether or not the acquisition of Michigan Gas Transmission Corporation by Panhandle Eastern Pipe Line Company will improve the financial condition of Michigan Gas and of Panhandle Eastern?

A. If I were attempting to arrive at a considered opinion on that matter, I certainly would give great weight to the opinion expressed by the S. E. C.

Q. Do you mean by your answer that you have not arrived at a considered opinion in that regard?

A. On that point, that is correct.

Mr. Littman: Mr. Culton and Mr. Baldrige, is my impression correct that representations were made by the officers of Panhandle Eastern Pipe Line Company before the Securities and Exchange Commission to the effect that the acquisition by Panhandle Eastern Pipe Line Company of the outstanding stock and the securities of [fol. 8440] Michigan Gas would improve the financial condition of both those companies?

Mr. Culton: Why, Mr. Littman, counsel would not undertake, where they had never heard the proceedings of the investigation or read the proceedings of the investigation, to state a conclusion as to what representations were made.

My suggestion is that you have before you the press release, the opinion of the S. E. C., the documents filed by Panhandle Eastern with the S. E. C. and in evidence, most of them, and we stand by what they say. Manifestly, Panhandle Eastern thought that this would be a good deal for it or it would not have insisted that the deal be made. We know that.

Mr. Littman: And manifestly, the Securities and Exchange Commission would not have approved the acquisition had it not felt it in the interest—

Mr. Culton: (Interposing) I think they have some kind of a finding along those lines.

By Mr. Littman.

Q. Mr. Drew, in response to an inquiry by Mr. Lee, I believe, you stated that the over-all investor's appraisal of risk of securities of Panhandle Eastern Pipe Line Company was 8.4 percent?

A. That was my calculation, yes, sir.

Q. As of what date?

A. Approximately November 1.

[fol. 8441] Q. What were the earnings that you used in arriving at this 8.4 percent figure?

A. \$5,714,218.

Q. Investors at that time knew that there was pending before the Federal Power Commission this rate investigation, did they not?

A. Investors, you say, knew that this litigation was pending? A. Yes.

A. Well, I am sure that there had been some notices in the press to that effect. They had the means of finding out, certainly.

Q. Certainly they were not in complete ignorance of that fact, were they?

A. My trouble in answering your question is that you generalize on the word "investors". That is a pretty broad term.

Q. You used the term "investors" when you state "investor's appraisal of risk" and I am using the precise term.

A. Then you mean the people who own the stock?

Q. People that own the stock—

A. (Interposing) Of this Panhandle Eastern?

Q. The bonds and preferred stock.

A. Yes, they should have known.

Trial Examiner: The advisory organizations all knew, [fol. 8442] of course, did they not?

The Witness: Yes.

